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**National Association of Federally-Insured Credit Unions**

July 23, 2021

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

**RE: RFC on Normal Operating Level Policy (Docket No. NCUA-2021-0038)**

Dear Ms. Conyers-Ausbrooks:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Request for Comment (RFC) issued by the National Credit Union Administration Board (Board), regarding the policy and methodology used to set the National Credit Union Share Insurance Fund (SIF) Normal Operating Level (NOL). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 125 million consumers with personal and small business financial service products. NAFCU and its member credit unions appreciate the opportunity to provide input on this RFC and urge the Board to establish a methodology that is consistent and transparent, that acknowledges the impact of the maturity of the NCUA Guaranteed Notes (NGNs), and ultimately, bring the NOL closer to the traditional level of 1.30 percent.

**General Comments**

NAFCU has consistently advocated for a NOL which provides adequate protection to taxpayers and minimizes the potential for premium charges to credit unions, while recognizing that every dollar held in the SIF is a dollar that will not be used to serve credit union members. The passage of the Credit Union Membership Access Act in 1998 granted the Board the authority to establish the NOL between 1.20 and 1.50 percent. In the years that followed, the Board maintained a NOL no higher than 1.30 percent. This period was a stable one for the SIF and one in which the Board never assessed a premium except during the Great Recession. However, in 2017 the NOL was increased to 1.39 percent, and today it is only slightly lower at 1.38 percent. NAFCU opposed the 2017 increase in the NOL and has consistently advocated for a return of the NOL to 1.30 percent.

The current policy calculates the NOL using three factors:

1. The modeled performance of the SIF over a five-year period, assuming a moderate recession. The stress scenario entails estimating three primary drivers of outcomes: insurance losses, insured share growth, and yield on investments.
2. The modeled potential decline in value of the SIF's claims on the corporate asset management estates in a moderate recession.

3. The projected equity ratio decline through the end of the following year without an economic downturn.

The methodology for calculating the NOL as well as two of the three factors used in the methodology are the direct product of the closure of the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund) and the concurrent distribution of its funds, property, and other assets and liabilities to the SIF. As will be discussed further, the maturity of the Stabilization Fund assets has therefore made two of the three factors of the methodology obsolete and necessitates reexamination of the final factor.

Recently, in order to bolster credit unions' ability to manage their money and shares on deposit, as well as to protect the equity ratio of the SIF, NAFCU has called for additional investment authorities. The Board should determine that a credit union may temporarily engage in additional investments that share a rational nexus to those explicitly outlined in the FCU Act, do not pose more risk than those activities explicitly authorized by the FCU Act, and are essential to carrying on the credit union's operations. This would ensure that credit unions and their members are well-positioned to endure the difficulties of this unprecedented time.

Such additional authority should apply in instances where a credit union has exhausted all available investment options explicitly listed in the FCU Act and is looking for opportunities to not only preserve its own net worth ratio but also preserve the equity ratio of the SIF.

### **The NOL Methodology Should Be Based on a Moderate Recession Scenario over a Three-Year Period**

A 2017 study conducted by the Federal Reserve reviewed the severity of the nine most recent recessions.<sup>1</sup> The researchers classified four of those nine recessions as severe, but only one severe recession (the Great Recession) has occurred since the early-1980s. Given the relative scarcity of severe recessions, it would be imprudent to manage the SIF to such a scenario.

When the NCUA adopted its current NOL methodology, it was based on a five-year forecast horizon. The length of this horizon was chosen in order to "cover the cycle of an economic downturn and the life of the NGN program."<sup>2</sup> Given that the final payment to NGN investors has already been made, the latter should no longer be a consideration.

While a certain amount of uncertainty is inherent in forecasting, extending the forecast horizon to five years strains the credibility of the process. Not only is the economic scenario itself more likely to diverge from whatever the next actual recession looks like in those later years, but the path of

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<sup>1</sup> Durdu, Bora, Rochelle Edge, and Daniel Schwindt (2017). "Measuring the Severity of Stress-Test Scenarios," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, May 5, 2017, <https://doi.org/10.17016/2380-7172.1970>.

<sup>2</sup> Closing the Temporary Corporate Credit Union Stabilization Fund and Setting the Share Insurance Fund Normal Operating Level, 82 Fed. Reg. 46298 (October 4, 2017).

recovery for the industry also grows more uncertain over time. It is worth noting that the stress test scenarios published by the Federal Reserve, on which the current NOL methodology is based, only extend 13 quarters.

Based on the historical analysis and the Federal Reserve forecast periods, NAFCU believes a NOL methodology based on a moderate recession over a three-year forecast horizon is appropriate.

### **The NOL Methodology Should Be Consistent and Transparent**

The Board has repeatedly referred to the NOL as the “Board’s *desired* equity ratio.”<sup>3</sup> However, the methodology used to determine the NOL should be divorced from any subjective approach and instead determined based on data and modeling, with the explicit goal of providing a safety net for credit unions and their members while ensuring that credit unions retain the maximum amount of capital to invest in services for their members. The Board should objectively evaluate the appropriate NOL based on data and modeling that is made publicly available for the industry to review and should not be hesitant to lower the NOL if the modeling indicates that it is safe to do so.

The Board’s current methodology relies on the Federal Reserve’s adverse economic scenario to provide the independent variables for the NOL calculation. The Federal Reserve did not publish an adverse scenario in 2020 or 2021, leading the Board to develop a proxy scenario based on a combination of the Federal Reserve’s baseline and severely adverse scenarios. In the absence of an adverse scenario from the Federal Reserve in the years ahead, the Board should use as its economic inputs a simple average of the baseline and severely adverse scenarios. This approach is easy to communicate, maintains a level of consistency with the current methodology, and ensures objectivity through the use of an external source for the model variables.

To support a more transparent process, the Board should request public comment any time the selected methodology results in a NOL calculation that exceeds 1.30 percent. While the selection of any criterion for subjecting the NOL process to public comment is bound to be somewhat arbitrary, the 1.30 percent level is already codified in the Federal Credit Union Act as the threshold below which the Board may charge a premium to insured credit unions. It is therefore a sensible place to provide an opportunity for stakeholder feedback. Part of the reason for the RFC is the elimination by the Federal Reserve of its adverse stress test scenario. Should such an issue arise in the future where the NOL methodology becomes obsolete, a more frequent comment process could help to resolve it in a timely manner with appropriate input from credit unions.

In its RFC, the Board asks about the inclusion of qualitative factors in the NOL methodology. NAFCU is opposed to the inclusion of qualitative factors as the selection of factors is inherently subjective and would reduce transparency. Furthermore, estimating the impact of qualitative factors would greatly increase the forecast uncertainty.

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<sup>3</sup> *Equity Ratio and Normal Operating Level*, National Credit Union Administration (July 7, 2021), <https://www.ncua.gov/support-services/share-insurance-fund/equity-ratio-normal-operating-level>

### **The Board Should Adjust the NOL Methodology to Recognize the Maturity of the NGNs**

The second factor considered in the current NOL methodology is the modeled potential decline in value of the SIF's claims on the corporate asset management estates in a moderate recession. In explanation of the decision to raise the NOL to 1.39 percent in 2017, the Board indicated that with the closure of the Stabilization Fund, they sought to ensure that the amount of equity held in the SIF would be sufficient to cover all the SIF's resulting exposures. These exposures included potential decline in the expected recovery of its claims on the NGNs and liquidated corporate credit union's asset management estates. The last of the NGNs matured on June 12, 2021. The risk associated with the SIF's claims on, and obligations related to the corporate asset management estates will decline and end as the estates are wound down and closed. Since the associated risks are no longer material, this factor should be removed from the NOL methodology.

Finally, the projected equity ratio decline through the end of the following year, assuming economic stability and normal growth, was originally devised as a backstop to ensure the SIF could stay above 1.20 percent under a moderate recession during the remaining life of the NGNs. With the upcoming maturity of the NGNs and pending conclusion of the corporate asset management estates, this factor should not be necessary going forward.

### **Conclusion**

NAFCU appreciates the opportunity to comment on the RFC regarding the NOL policy and methodology. NAFCU requests that the Board continue to use a model-based methodology while acknowledging the reduction of risks associated with the maturity of the NGNs. If you have any questions, please do not hesitate to contact me at [clong@nafcu.org](mailto:clong@nafcu.org) or (703) 842- 2276 or James Akin, Regulatory Affairs Counsel at 703-842-2268 or [jakin@nafcu.org](mailto:jakin@nafcu.org).

Sincerely,



Curtis Long  
Vice President of Research and Chief Economist