NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

December 28, 2017

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Comments on Proposed Rule – Capital Planning and Supervisory Stress Testing
RIN: 3133-AE80

Dear Mr. Poliquin,

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I would like to share with you our thoughts regarding NCUA's proposed rule on capital planning and supervisory stress testing.

NAFCU supports the notion of prudent capital planning and believes that covered credit unions are not only comfortable with this process, but have long possessed the ability to forecast the effects of unfavorable economic conditions on capital. When NCUA proposed the first iteration of its capital planning and stress testing rule, NAFCU recommended that covered credit unions be able to conduct their own stress tests because larger credit unions already engaged in advanced capital planning. Accordingly, we agree with NCUA that covered credit unions deserve the flexibility to conduct their own stress tests. In addition, the proposal's tiered regulatory approach represents a promising start to what NAFCU hopes will be a broader conversation about recalibration of stress testing and capital planning assumptions. NAFCU hopes to work with NCUA to reexamine the extent to which formal capital plans and stress tests are necessary to ensure safety and soundness.

General Comments

Under the proposed rule, covered credit unions would be subject to tiered regulatory requirements tailored to reflect their size and experience in capital planning. Covered credit unions that have undergone fewer than three capital planning cycles would not be subject to stress testing, while credit unions that have $20 billion or more in total assets would be subject to largely the same requirements contained in current Subpart E of Part 702. The proposal also indicates that NCUA would review the capital plans of tier I and tier II credit unions through the supervisory process, and that covered credit unions would be able to conduct their own stress tests.

Agency administration of capital planning requirements and validation of stress tests would eliminate reliance on expensive contractors. Contracts with BlackRock to perform stress testing in 2014 and 2015 cost NCUA $2.3 million and $1.7 million respectively.[1] NAFCU anticipates that agency-validated stress testing should yield significant budgetary savings as NCUA develops examiner capacity.

NAFCU also appreciates the additional flexibility granted to tier I and tier II credit unions. Under the proposed rule, credit unions that have just reached $10 billion in total assets will have more time to adjust to new capital planning and stress testing expectations. Furthermore, incorporation of capital planning within the supervisory process will spare tier I and tier II credit unions the unnecessary burden of having to submit a capital plan for NCUA's formal approval. On the other hand, tier III credit unions would be subject to nearly all of the same requirements that exist under the current capital planning and stress testing rules.

NAFCU believes that a tiered regulatory approach is a good first step, but is fundamentally limiting—particularly for the largest credit unions. Capital planning requirements should not only be tailored based on the complexity and financial condition of covered credit unions, but also contextualized in terms of overall industry risk. Congress chose not to include any mandate in the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) that NCUA perform stress tests on credit unions. Accordingly, NCUA should think beyond the scope of the current rulemaking and determine whether stress testing is the best tool for assessing a credit union's financial health.

Credit unions are less risky than banks, as evidenced by the industry's resiliency during the financial crisis, so it would be appropriate to adopt flexible supervisory guidance with respect to evaluation of capital plans. Furthermore, credit unions continue to demonstrate exceptional financial health, with the vast majority of industry assets held by CAMEL 1 and 2 institutions. Based on these factors and the strong capital position of the credit union industry, NAFCU believes that NCUA's safety and soundness mission can evolve beyond the capital planning assumptions which arose out of the financial crisis.

Covered credit unions tiers and stress testing parameters should be scaled to promote more meaningful relief.

NCUA should reconsider the characteristics used to define each covered credit union tier under the proposal. Ideally, credit union tiers should be defined in terms of complexity and financial condition as opposed to just asset size. Such an approach would accord with the Treasury's recommendation that stress-testing and capital regulations be tailored to the business models and complexity of institutions in order to avoid maintenance of costly compliance infrastructure and a "one-size-fits-all" approach.[2]

---

[1] *See* House Committee on Financial Services, 114th Congress – National Credit Union Administration Operations and Budget, 144 (July 23, 2015), available at https://www.gpo.gov/fdsys/pkg/CHRG-114hhrg97159/pdf/CHRG-114hhrg97159.pdf.
[2] *See* United States Department of the Treasury, A Financial System That Creates Economic Opportunities, 9 (July 2017), available at https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

In the alternative, NCUA should revise each tier using a wider range of asset sizes. Specifically, tier II credit unions should be defined as credit unions that exceed $35 billion in total assets, and tier III credit unions should be defined as credit unions that exceed $50 billion in total assets. These adjustments would scale capital planning expectations to the same asset range used for the Dodd-Frank Act Stress Test (DFAST), which is used for stress testing banks between $10 billion and $50 billion in total assets.[3] In addition, a credit union should not become a covered a credit union until its most recent four-quarter average total assets reaches $10 billion, as reported on its Call Report. Currently, a federally insured credit union becomes a covered credit union once it reaches $10 billion in total assets as of March 31 of a given calendar year. Assessing the covered credit union threshold using a four quarter average of total assets would afford credit unions additional time before transitioning into tier I status and reflect the way a bank becomes a "covered bank" for DFAST purposes.[4]

NCUA should also seek to develop capital planning requirements tailored to individual tiers of covered credit unions. In other words, capital planning expectations should be responsive to the complexity of individual tiers rather than calibrated broadly for all covered credit unions. This approach for capital plan reviews would accord with NCUA's stated goal of aligning its capital planning expectations based on both size *and* complexity. NAFCU believes that tailored guidance is necessary to afford credit unions appropriate flexibility in developing capital plans because credit unions of similar size may face significantly different capital risks.

NCUA should evaluate the capital plans of very well capitalized credit unions through the supervisory process.

The proposal's tiered approach should include an off-ramp exemption for stress testing. Specifically, NAFCU believes that credit unions that have a net worth ratio of at least ten percent should be exempt from all stress testing requirements described in the proposed rule. Such an exemption would accord with the Treasury's recommendations regarding DFAST and CCAR off-ramps for banks.[5]

NCUA should also consider relaxing capital planning requirements for very well capitalized credit unions. NAFCU believes that any covered credit union with a net worth ratio of least ten percent should have its capital plan reviewed as part of the supervisory process every two years. NAFCU suggests this change because a periodic and formal assessment of capital plans is not essential for credit unions, which are cooperatively owned, not-for-profit cooperatives. Unlike banks, credit unions do not plan stock buybacks or declare dividends based on formal capital plan approval.

NAFCU also recommends that NCUA review all covered credit union capital plans through the supervisory process. This would permit NCUA examiners to more efficiently communicate concerns or questions regarding capital plans using a risk-based approach. It would also allow

---

[3] *See* 12 CFR § 235.203.
[4] *See* 12 CFR § 235.202(d).
[5] *See* United States Department of the Treasury, A Financial System That Creates Economic Opportunities at 12.

credit unions to reach resolution on interpretative differences well in advance and mitigate certain timing challenges associated with formal resubmission of capital plans. In addition, a two year capital planning cycle for very well capitalized credit unions would grant meaningful relief without compromising NCUA's ability to accurately forecast risk over a nine quarter cycle. A two year review cycle would resemble what the Treasury has proposed for banks.[6] Furthermore, NCUA could reserve the right to review capital plans during off-years when severely adverse economic conditions arise, or if the credit union's net worth ratio falls below the required ten percent.

NAFCU also urges NCUA to determine the extent to which current capital planning requirements are redundant in light of risk-based capital and interest rate risk rules. If credit unions are already measuring asset quality or the effect of interest rate shocks relative to capital, then these requirements should be consolidated into a single assessment to avoid duplication of effort.[7]

When NCUA reserves the right to conduct its own stress testing, it should adopt transparent procedures for collection and validation of stress test data.

NCUA's data collection templates, which are used for gathering information for stress testing purposes, have occasionally switched optional data fields to priority data fields. In addition, it appears that NCUA periodically revises the content of its data templates without advance notice. These practices have necessitated publication of a lengthy Q&A document which describes the Office of National Examination and Supervision's data submission expectations. NAFCU believes that periodic and unexplained revisions to the data templates create confusion and undermines NCUA's goal of promoting transparency. NAFCU also urges NCUA to eliminate monthly stress test data collection for credit unions that conduct their own stress testing.

To ensure that credit unions can plan in advance for stress tests, NCUA should seek to publish stress test instructions approximately a year in advance. The instructions should also disclose the stress test methodology relied upon by NCUA. In addition, NCUA should justify changes in stress testing principles by explaining the need for any new or modified data inputs. These guarantees would achieve NCUA's ongoing goal of promoting greater transparency and ensure that its stress test methodology can be independently validated.

NAFCU also believes that if NCUA reserves the right to conduct stress tests on covered credit unions, it should follow the same stress test instructions provided on its web site. Proposed Section 702.506(b)(1) describes the requirement for credit unions to conduct stress tests according to NCUA's instructions. However, the proposal is unclear regarding how specific these instructions will be and whether they will accommodate a range of stress test models that are responsive to the unique characteristics of individual credit unions. To ensure consistency, NCUA-conducted stress tests should adhere to these same principles.

---

[6] *See id.*
[7] *See id*. at 50.

NCUA should also clarify whether new capital planning expectations will differ between proposed tiers. For example, tier I credit unions would not be subject to stress testing yet would still undergo capital plan review through the supervisory process. The proposed rule alters the mandatory elements of a capital plan in current 702.504(b), but retains certain stress testing concepts (e.g., reverse stress testing). NAFCU asks that NCUA specify how evaluation of capital plans will differ for tier I credit unions given that some elements of the capital plan are closely linked with stress testing.

Conclusion

NAFCU appreciates the opportunity to comment on NCUA's proposed rule for capital planning and supervisory stress testing. The proposed rule offers a promising framework for granting covered credit unions additional capital planning flexibility and autonomy; however, more must be done to reevaluate critical assumption underlying tiered thresholds and the need for formal stress testing. NAFCU supports changes to the proposed rule that would better align the tiered framework with the Treasury's recommendations for stress testing, promote greater transparency, and ensure that capital planning standards are appropriately tailored to a credit union's business model, complexity and financial condition. If NAFCU can be a source of any additional information relevant to the proposed rule, please do not hesitate to contact me at 703-842-2266, or amorris@nafcu.org.

Sincerely,

Andrew Morris
Regulatory Affairs Counsel