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National Association of Federally-Insured Credit Unions

B. Dan Berger
President & Chief Executive Officer

November 9, 2020

The Honorable Rodney E. Hood, Chairman
The Honorable Todd M. Harper, Board Member
The Honorable J. Mark McWatters, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: NAFCU's Regulatory Priorities

Dear Chairman Hood and Board Members Harper and McWatters:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I would like to share with you the top priorities of our nation's credit unions for the remainder of 2020. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 122 million consumers with personal and small business financial service products. These priorities outline areas that are best suited for regulatory relief and expanded flexibility to help assist credit unions as they continue to manage the impacts of the COVID-19 pandemic. NAFCU urges the National Credit Union Administration (NCUA) to evaluate the below issues and enact the requested policy modifications to better equip our nation's credit unions to emerge healthy and strong from the pandemic and resultant economic downturn. We hope that you will work with us to address these concerns.

Executive Summary

1. *Expanding Virtual Meetings.* The NCUA should provide guidance permitting virtual annual meetings and all solely virtual board meetings in 2021 to help protect the health and safety of credit union volunteers.
2. *Managing Unexpected Share Growth.* Considering the unique circumstances, the NCUA should provide more specialized and flexible parameters for meeting certain capital and supervisory requirements.
3. *Additional Investment Opportunities.* The NCUA should expand investment opportunities available to credit unions, including in the areas of asset-backed securities and corporate bonds.
4. *Capitalizing Interest on Loan Modifications.* Establishing parity with bank regulators' treatment of loan modifications will ease burdens on both credit unions and consumers.
5. *Adopting Broader Capital Reform.* Broader capital reform is critical during this time, including finalization of the subordinated debt rule, further guidance on asset securitization, and further delay of the risk-based capital rule.

6. *Finalizing an Efficient and Measured Budget.* In finalizing the 2021 budget, efficiency, transparency, and prudent management of credit union dollars is essential to the safety and soundness of the industry.

NCUA Regulatory Priorities

Expanding Virtual Meetings

In March 2020, the agency issued a Letter to Federal Credit Unions, 20 FCU-02, providing annual meeting flexibility for meetings scheduled in 2020 if credit unions adopt a bylaw provision for an exception to the in-person quorum requirement, if certain conditions are met. One of those conditions is the NCUA issuing general or specific guidance notifying credit unions that it is appropriate to invoke the bylaw provision. The NCUA has yet to issue such guidance for annual meetings conducted in 2021. Considering the number of COVID-19 infections has reached new peaks and is not anticipated to significantly decline during the winter months, NAFCU requests the NCUA quickly prepare and release such guidance over the coming weeks that credit unions may rely on to adjust their annual meetings scheduled for early in 2021 to a virtual platform.

Similarly, Article 6, Section 5 of NCUA's model bylaws require that a credit union's Board of Directors conduct one regular meeting each calendar year in person. This is not an express requirement in the *Federal Credit Union Act* (FCU Act); therefore, the NCUA has the latitude to alter this meeting requirement to provide for additional flexibility. NAFCU urges the NCUA to eliminate this requirement for an in person monthly Board of Directors meeting in light of credit unions' illustrated ability to accurately and safely operate in a virtual environment. Alternatively, the NCUA should issue a Letter to Federal Credit Unions providing for the removal of the requirement for any year during which the national state of emergency concerning the pandemic continues be in place. Removal of this requirement will better protect credit union volunteers, employees, and members as the pandemic continues.

Managing Unexpected Share Growth

At the September NCUA Board meeting, the agency revealed that the equity ratio fell 13 basis points since the prior year end, from 1.35 percent to 1.22 percent. Staff emphasized that this drop was due to extraordinary share growth related to the COVID-19 crisis. The agency anticipates that once insured credit unions' capitalization deposit accounts are trued up, the equity ratio will increase to 1.33 percent. The practical impact of the increase in share growth is that some credit unions are facing difficulties in managing their net worth ratios and are concerned about the attendant supervisory implications. Other credit unions who have seen large share growth are concerned about the consequences of quickly crossing significant thresholds including the \$10 million threshold and the \$10 billion threshold without adequate time to prepare for the transition.

The Honorable Rodney E. Hood, Chairman
The Honorable Todd M. Harper, Board Member
The Honorable J. Mark McWatters, Board Member
November 9, 2020
Page 3 of 7

First, NAFCU requests that the NCUA extend beyond December 31, 2020, the prompt corrective action (PCA) relief issued in May 2020 to account for ongoing challenges as a result of increases in share growth. This extension will ensure that credit unions are able to operate efficiently and can maintain sufficient liquidity into 2021 when the economic impacts of the pandemic may be further exacerbated. The NCUA should also consider excluding Paycheck Protection Program (PPP) loans from the calculation of a credit union's total assets, regardless of whether the PPP loan was pledged as collateral for a loan from the PPP Lending Facility, to provide even broader relief.

Second, the NCUA should consider issuing a rule to temporarily revise its definition of total assets, as permitted under the FCU Act, as a means of alleviating regulatory stresses caused by excess share growth. As credit unions cross certain asset thresholds, they encounter new regulatory requirements, which might include heightened supervision, stress testing, or eventually risk-based capital compliance. In normal times, credit unions can reasonably predict how quickly they will grow and can plan in advance to meet new standards or expectations. For credit unions on the cusp of these asset-based thresholds, the pandemic has largely frustrated this process, particularly for those nearing the \$10 billion mark. Delaying recognition of excess share growth would be an appropriate measure to mitigate the regulatory consequences of pandemic-related capital dilution and grant credit unions additional flexibility. In practical terms, the NCUA could accomplish such relief by adjusting its definition of total assets.

In its proposed rule regarding the transition to the Current Expected Credit Losses (CECL) standard, the NCUA acknowledged that Section 216 of the FCU Act does not define the term total assets, which is left to the "regulatory discretion of the Board." Consequently, it lies within the Board's authority to tailor threshold-based regulatory standards vis-à-vis the total assets definition to better reflect the reality of capital dilution—as opposed to depletion—where unexpected asset growth was predominantly caused by an influx of shares. Providing additional flexibility in this domain would be a logical extension of the agency's interim final rule regarding PCA relief. It could also operate in a similar fashion to the NCUA's CECL phase-in, by permitting the agency to delay recognition of excess share growth until the disruption and stresses of the pandemic give way to a more normal economic environment. NAFCU would also welcome a proposal providing for consideration of rolling averages of a credit union's total assets rather than a present-day snapshot of total assets for purposes of determining if a credit union has crossed the \$10 billion threshold for enhanced supervision and regulatory requirements.

More specifically, the NCUA should also provide additional transition time for those credit unions that may cross the \$10 million threshold and the \$10 billion threshold. With respect to \$10 million threshold, this is particularly critical as it applies to the NCUA's recently proposed rule regarding the CECL standard. In the rule, the NCUA proposes exempting credit unions below \$10 million in assets from compliance with Generally Accepted Accounting Principles and, accordingly, the new CECL standard. However, if credit unions quickly and potentially only temporarily cross that threshold, they should be permitted a reasonable time to transition to new compliance

requirements, including the costly and cumbersome CECL standard. A reasonable timeline should be at least one year for such credit unions.

Finally, the NCUA should consider increased coordination with the Bureau of Consumer Financial Protection (CFPB) for those credit unions who quickly and, perhaps temporarily, cross the \$10 billion threshold. The expedited timeline at which these credit unions may cross the \$10 billion threshold poses significant burdens as those institutions as they struggle to prepare for enhanced supervision by not only the NCUA but also the CFPB. Accordingly, the NCUA should work with the CFPB to provide a longer timeline for credit unions who may be at or above the \$10 billion threshold on March 31, 2021 but could fall below that threshold shortly thereafter. As for the NCUA's independent supervisory function for credit unions that cross this threshold, the agency should likewise provide a longer transition period before credit unions are examined by the Office of National Examinations and Supervision.

Additional Investment Opportunities

To help credit unions better cope with the large influx of deposits, the NCUA should consider expanding, even if solely on a temporary basis, the permissible investment authorities for credit unions. As outlined above, the decline in the equity ratio in the first half of 2020 was a result of increased deposits. To help credit unions combat the potential dilution of their net worth ratios, NAFCU urges the NCUA to evaluate existing authorities to permit additional investment options under the FCU Act and its regulations. These authorities could include explicit authority under Part 703, as an incidental power under Part 721 necessary to manage risks that have arisen as a consequence of this unexpected share growth, or through emergency authority directly in response to the pandemic. Additional investment opportunities could include permitting (1) investment in asset-backed securities, similar to the authority provided to credit union service organizations under Part 704; and (2) investment in corporate bonds similar to state laws applicable to state-chartered credit unions. This flexibility would provide immediate relief to credit unions facing share growth and better preserve the equity ratio of the SIF.

Capitalizing Interest on Loan Modifications

On September 1, 2020, NAFCU's Board of Directors Chair and Regulatory Committee wrote to request the agency reinterpret Appendix B to Part 741 of its regulations to permit the capitalization of interest on loan modifications. The current interpretation poses challenges for both borrowers and credit unions, impeding the credit union's ability to work with borrowers who may not be able to meet their loan payment obligations due to the economic impacts of the COVID-19 pandemic. The NCUA should act now to issue a rule permitting the capitalization of interest to align with GAAP, the practices of Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs), and the other banking regulators.

The current loan modification options (e.g., capturing the deferred interest first, requiring the borrower to pay deferred interest upfront or on a shortened term, extending the loan, or bifurcating the loan to create a separate non-interest bearing loan for the deferred interest) create confusion, impose additional payment burdens on the borrower, and add immense operational burdens on credit unions. These impacts are further amplified by the ongoing impacts of the pandemic and economic recovery. The simplest solution would be to permit credit unions to capitalize the interest accrued during the forbearance period, adding it to the principal loan amount, and re-amortizing the loan once the borrower exits forbearance and resumes regular payments. NAFCU urges the NCUA to quickly resolve these concerns by issuing a rule reinterpreting Appendix B to Part 741 to permit the capitalization of interest.

Adopting Broader Capital Reform

NAFCU supports the swift finalization of a streamlined subordinated debt rule to expand capital opportunities for all credit unions during this period of economic uncertainty. The procedural complexity of the NCUA's proposed rule must be reduced in order to expand the accessibility of supplemental capital and preserve the existing secondary capital market opportunities for low-income designated credit unions (LICUs). As outlined in NAFCU's July 8, 2020 letter on the subordinated debt proposed rule, the proposal contained several procedural requirements that could serve to counteract some of the benefits afforded by the rule. In the final rule, the NCUA should not classify subordinated debt as a security because there is no precedent for categorizing these transactions as such and the agency's internal appraisals of subordinated debt's securities-like features are best communicated on a case-by-case basis. Furthermore, the agency's prior lack of commentary regarding the relationship between secondary capital and securities has not, in the past, impaired the successful ongoing management of these capital accounts or placed them in any legal jeopardy.

The final rule should also, among other things, permit credit unions to be both issuers and purchasers of subordinated debt instruments, streamline the application process, accelerate the review process for subordinated debt applications from 60 days to 45 days, and waive the requirement for LICUs to prepare complex offering documents for offerings of \$10 million or less. NAFCU also supports changes to the FCU Act that would permit credit unions to count subordinated debt towards the net worth ratio calculation to alleviate current constraints on building net worth and asks that the NCUA support this amendment as well.

Another avenue for additional capital relief for credit unions comes in the form of asset securitization. In June 2017, the NCUA explained that a federal credit union has the requisite authority to issue and sell securities as part of its incidental powers under the FCU Act. Although the NCUA has indicated its intent to provide further guidance on the topic of asset securitization, to date there has been no progress from the agency on publicly available guidance or a rulemaking. In a letter dated February 21, 2018, NAFCU previously outlined measures for the NCUA to

The Honorable Rodney E. Hood, Chairman
The Honorable Todd M. Harper, Board Member
The Honorable J. Mark McWatters, Board Member
November 9, 2020
Page 6 of 7

incorporate into its guidance and reiterates those requests now as the agency continues to work on providing credit unions with more clarity regarding the asset securitization process.

NAFCU also remains concerned about the regulatory burden and increased costs associated with the implementation of the risk-based capital (RBC) rulemaking. The appropriate level of credit union capital requires further study to establish parity with bank capital requirements. Additionally, the NCUA should provide a rule that does not rely on an arbitrary asset threshold but rather evaluates credit unions on a case-by-case basis, including their activities, and determining whether their net worth ratios provide adequate protection against material risk, regardless of their asset size. NAFCU also encourages the NCUA to swiftly propose a community bank leverage ratio analog that credit unions can use to satisfy new requirements in the RBC rule.

Relatedly, the NCUA should also permanently grandfather all goodwill to exclude it from the numerator calculation of a credit union's RBC ratio. The expiration of the goodwill grandfathering provision will cause some credit unions to face significant disruptions to their growth strategies and ability to offer products and services to their members. NAFCU will continue to advocate for the NCUA to revise and further delay its RBC rule.

Finalizing an Efficient and Measured Budget

Over the past decade, the NCUA operating budget has increased by about 57 percent, while the credit union industry has consolidated by 32 percent. Given the economic impacts of the pandemic, NAFCU urges the agency to find opportunities for further reductions to its 2021 draft budget, which proposed another 3.8 percent increase over the 2020 budget. Moreover, it is imperative that the NCUA operate in a fiscally prudent manner to alleviate any waste and ensure that credit unions are not being over-charged in annual operating fees assessed. NAFCU appreciates the NCUA's recent rulemaking efforts to remove government-backed loans, including PPP loans from the total asset calculation for purposes of assessing the annual operating fee. Additionally, NAFCU is supportive of the proposed changes to amend the calculation of total assets based on the four most recently reported quarters to minimize the potential over-charging of operating fees.

Taking into account the cost savings from 2020 due to reduced travel expenses, the NCUA should quickly pivot to more virtual exams going forward, and incorporate lessons learned to achieve reductions by cutting unnecessary travel and other expenses. Although NAFCU's members support continued in person interaction with examiners during the exam process instead of a fully virtual exam posture, some efficiencies can be achieved with respect to the amount of travel required for examiners.

These resources would be better allocated to ensuring credit unions have the tools necessary to remain healthy and grow if they decide to expand their fields of membership. NAFCU continues to urge the agency to consider further modernization of its field of membership rules and stresses that the cost savings from the travel expenses described above would be better targeted toward

The Honorable Rodney E. Hood, Chairman
The Honorable Todd M. Harper, Board Member
The Honorable J. Mark McWatters, Board Member
November 9, 2020
Page 7 of 7

helping the Office of Credit Union Resources and Expansion to streamline their approval of charter changes so that credit unions can continue to help their communities thrive.

Conclusion

NAFCU would like to thank the NCUA for its steadfast focus on providing COVID-19 relief measures. Over the remaining weeks in 2020, NAFCU recommends that the NCUA address the critical issues outlined above, including issuing guidance permitting credit unions to conduct annual meetings and all board meetings virtually in 2021, providing ways to manage unexpected share growth, adding new investment opportunities for credit unions experiencing large share growth, permitting the capitalization of interest on loan modifications, pursuing broader capital reform, and preparing an efficient and measured 2021 budget. Thank you for your consideration and we look forward to working with you to address these priorities. If we can answer any questions or provide you with additional information on any of these issues, please do not hesitate to contact me or Ann Kossachev, NAFCU's Director of Regulatory Affairs, at 703-842-2212 or akossachev@nafcu.org.

Sincerely,

A handwritten signature in black ink, appearing to read "B. Dan Berger". The signature is stylized and cursive, with a large initial "B" and "D".

B. Dan Berger
President and CEO