NAFCU

3138 10th Street North
Arlington, VA 22201-2149
703.842.2215 | 800.336.4644
F: 703.522.2734
dberger@nafcu.org

National Association of Federal Credit Unions | www.nafcu.org

B. Dan Berger
President & Chief Executive Officer

August 18, 2015

The Honorable Debbie Matz, Chairman
The Honorable Richard Metsger, Vice Chairman
The Honorable Mark McWatters, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: NCUA Examination Scheduling Policy

Dear Chairman Matz, Vice Chairman Metsger, and Board Member McWatters:

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 to you regarding the National Credit Union Administration's (NCUA) examination scheduling policy.

First and foremost, NAFCU and our members appreciate the agency's commitment to increasing transparency around NCUA's budgeting and expenditure processes. Over the past several months, NCUA has not only developed a dedicated budget resource center on its website, but it has also posted detailed information about the agency's spending plans, annual fund audits, and a wealth of other budget information. This NAFCU-sought transparency provides much-needed clarity to the industry about how the agency prioritizes and spends the dollars that it assesses from credit unions.

In reviewing the newly-disclosed budget documents, NAFCU and our members observed that NCUA budgeted roughly $231 million on employee pay, benefits and travel, $6.39 million of which is for airfare and auto rentals alone. To streamline and reduce these operating costs, NAFCU suggests that the agency move back to an 18-month examination cycle in order to cut duplicative examination expenses. NCUA currently has the authority to implement this longer examination cycle for healthy credit unions, a practice which the agency has done in the past. Further, as indicated by H.R. 1553, *the Small Bank Exam Cycle Reform Act of 2015*, Congress has recognized the benefits of moving lower risk financial institutions to an 18-month examination cycle. Although this legislation does not apply to credit unions, NAFCU believes that an 18-month exam cycle for financially sound, well-managed institutions, as compared to a 12-month cycle, is one way to provide relief and help regulators control examination costs. Accordingly, NAFCU encourages the agency to reinstitute this policy.

NCUA's Examination Schedules

NCUA refined its supervision and examination process in 2001, and, in doing so, developed a Risk-Focused Examination (RFE) approach. Under this approach, eligible federal credit unions had an examination completed every 12 to 24 months, with a target completion frequency of 18 months. To be eligible, a federal credit union must have posed minimal or no risk to the National Credit Union Share Insurance Fund (NCUSIF). *See* Letter to Federal Credit Unions 01-FCU-05 (August 2001). NCUA considered a federal credit union "low risk" if it, among other things, had been assigned a composite CAMEL code 1 or 2 for the previous two examinations.

In 2008, however, during the height of the financial crisis, the agency reverted back to a 12-month program. NCUA concluded that the adverse economic conditions and distress to the nation's entire financial system placed credit unions and the NCUSIF at a greater risk of loss. The agency determined that it needed more frequent onsite contacts in order to deal with the challenges of the financial crisis more effectively and proactively. This decision, while made in the abundance of caution, was costly for our industry. In total, NCUA increased its budget $6.8 million over 2009 and 2010 to cover 56 new positions, including 50 examiners, five supervisory examiners and one human resource specialist.

While NAFCU and our members appreciate NCUA's diligent and proactive work during the financial crisis for those credit unions that needed it, we firmly believe that the credit union system would benefit from going back to an 18-month examination cycle. Credit unions have healed along with the overall U.S. economy. Accordingly, NAFCU urges the agency to exercise its statutory authority and implement an 18-month examination cycle. Such a program would preserve NCUA's ability to address risk within the system in a timely manner, but would allow the agency flexibility in its staffing and budgeting process, thereby saving credit unions and NCUA valuable time, resources and money.

Statutory Authority

The *Federal Credit Union Act* (FCU Act) generally provides that "federal credit unions shall be . . . subject to examination by, and for this purpose shall make its books and records accessible to, any person designated by the Board." *See* 12 U.S.C. § 1756. Further, the FCU Act states that:

> "[t]he Board shall appoint examiners who shall have power, on its behalf, to examine any credit union making application for insurance of its member accounts, or any closed insured credit union whenever in the judgment of the Board an examination is necessary to determine the condition of any such credit union for insurance purposes. Each examiner shall have power to make

> a thorough examination of all of the affairs of the credit union and shall make a full and detailed report of the condition of the credit union to the Board. . . ."

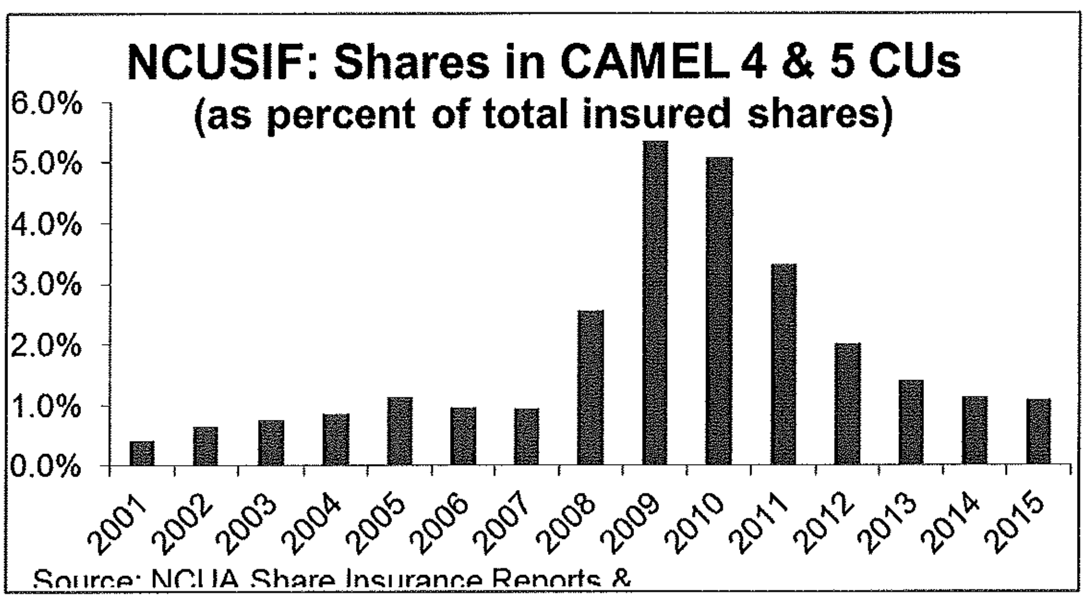
See 12 U.S.C. § 1784(a).

While the FCU Act does not specifically address whether credit union examinations should focus on calendar year examination cycles, NCUA has full authority to interpret the statute as it sees fit, so long as the agency's construction of the FCU Act's language is reasonable[1]. Historically, NCUA has not interpreted Sections 1756 and 1784 as requiring an examination of all credit unions each calendar year. Rather, the agency's position is that the examination cycle for credit unions should be determined by risk to the NCUSIF, economic trends, and staff and resource availability.[2]

Considering the (1) current risk to the NCUSIF, (2) economic trends, and (3) NCUA staff and resource availability, NAFCU believes that all credit unions do not warrant an 12-month exam cycle. As detailed below, NAFCU and our members contend that 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.

Current Risk to the NCUSIF

NAFCU believes that the risk present in today's credit union industry does not expose the NCUSIF to the possibility of substantial loss that would warrant an annual examination cycle. Instead, as demonstrated by the chart below, the current percentage of shares held by CAMEL 4 and 5 credit unions is significantly reduced from 2008, when the agency implemented a 12-month program, as well as roughly in line with 2001-2007, when NCUA maintained an 18-month program.



[1] *See Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

[2] *See* Instruction 5000.15 (September 13, 2001).

Further, NAFCU believes that frequency of onsite examinations does not directly correlate to increased protection of the NCUSIF. An analysis of previous Material Loss Reviews indicates that examiners' ability to identify and resolve risks within a credit union does not hinge on frequency of onsite contacts, but rather on their thoroughness in evaluating a credit union's internal controls, and the effectiveness of implementing resolutions to concerns raised during examinations.[3] NAFCU and our members believe that an 18-month examination cycle with diligent examiner identification and resolution of issues, coupled with the robust information collected quarterly through the 5300 Call Report, will yield a thorough assessment of the health and potential risk at each credit union, thereby allowing NCUA to appropriately and efficiently mitigate any risk to the NCUSIF. Simply put, an 18-month risk-focused program would efficiently and effectively measure risks present and anticipated in the future, while simultaneously retaining NCUA's ability to address emerging high-risk activity on a case-by-case basis.

Economic Conditions

Comparing present conditions to 2001 and 2008 – the years NCUA amended its examination cycles in response to industry conditions – NAFCU believes that today's environment warrants an 18 month examination cycle because the economic trends and health of the NCUSIF compare favorably to 2001-2007 when NCUA employed a 12 to 24 month examination cycle.

To evaluate the health of and the risk to the NCUSIF, NAFCU examined the equity ratio and the distribution of CAMEL codes across the industry. To survey the financial condition of the credit union industry, NAFCU looked at capital ratios, delinquencies, and Return on Assets (ROA). Finally, to examine the overall health of the U.S. economy, NAFCU studied Gross Domestic Product (GDP), unemployment, household debt service rations, and consumer sentiment. As demonstrated by the chart on the following page, NAFCU's analysis in each of these areas concluded that current conditions are demonstratively better than 2008-2014, and favorably similar to 2001-2007.

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[3] *See* Office of Inspector General, National Credit Union Administration, OIG–10–15, Material Loss Review of Ensign Federal Credit Union, (September 23,2010), available at *http://www.ncua.gov/about/Leadership/CO/OIG/Documents/OIG201015MLREnsign.pdf;* Office of Inspector General, National Credit Union Administration, OIG–10–16, Material Loss Review of St. Paul Croatia Federal Credit Union (October 7, 2010), available at http://www.ncua.gov/about/Leadership/CO/OIG/Documents/OIG201016MLRStPaulCroatian.pdf; Office of Inspector General, National Credit Union Administration, OIG–12–11, Material Loss Review of O.U.R Federal Credit Union (August 2, 2012), available at http://www.ncua.gov/about/Leadership/CO/OIG/Pages/MaterialLossReviews.aspx

	2001-2007*	2008-2014*	2015
CAMEL Codes			
CAMEL 4/5 (% of ins. shares)	0.8%	3.0%	1.1%
SIF Health			
Equity Ratio (at year end)	1.28%	1.29%**	1.29%
Industry Health			
Net Worth Ratio	11.1%	10.5%	10.9%
Delinquency Ratio	0.8%	1.4%	0.7%
ROA	0.9%	0.5%	0.8%
Economic Health			
GDP	2.5%	1.0%	2.3%
Unemployment	5.2%	7.9%	5.5%
Household Debt Service Ratio	12.5%	11.0%	9.9%
Consumer Sentiment (U. of M.)	89.0	72.7	94.4

* Annual averages
** includes assessments in 2009 and 2010

Resource Availability

Recently, NCUA has recognized that its examination resources should be streamlined for well-run, financially sound credit unions. In the first quarter of 2015, the agency instituted this concept through its Small Credit Union Examination Program, under which NCUA has begun to reallocate agency resources from smaller, well-run credit unions, to larger, more complex institutions. This targeted and streamlined examination program for financially and operationally sound federal credit unions with less than $30 million in assets demonstrates that NCUA has the flexibility to decrease onsite presence, while maintaining the ability to precisely focus on the most pertinent areas of risk, including lending, recordkeeping, and internal control functions. NAFCU and our members believe NCUA should exercise this same approach across all well-run, healthy credit unions by returning to an 18-month examination cycle.

Conclusion

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. Specifically, NAFCU suggests that NCUA allow federal credit unions 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.

Should you have any questions or would like to discuss these issues further, please feel free to contact me by telephone at (703)-842-2215, or Alicia Nealon, NAFCU's Director of Regulatory Affairs at (703) 842-2266 or anealon@nafcu.org.

Sincerely,

B. Dan Berger
President/CEO

cc: Mr. Mark A. Treichel, Executive Director
Mr. Larry Fazio, Director of the Office of Examination and Insurance