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Fred R. Becker, Jr.
President and CEO

October 4, 2010

The Honorable Deborah Matz
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Regulatory Improvements and Management tools

Dear Chairman Matz:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions, I am writing to you regarding some suggested improvements that we believe should be made with regard to the National Credit Union Administration's (NCUA) examination process, as well as other related issues.

As you know, NAFCU has been aggressively seeking to assist its members in complying with the formidable volume and mounting complexity of regulations that unfortunately stem from the current economic environment. As part of this effort, we recently issued a white paper, entitled "Managing Examinations in Challenging Times." I very much appreciate your, and the other National Credit Union Administration (NCUA) Board members, acknowledgement of the usefulness of this document to our industry. We hope that the document will not only significantly assist credit unions, but NCUA examiners in managing the ever increasingly rigorous examination process.

There are also, however, a number of issues that we believe NCUA can play a central role in helping resolve. With these changes, credit unions will be able to better manage these difficult economic times.

Examination Issues

In prior correspondence, NAFCU has consistently alerted NCUA about our member's concerns with various examination issues. We continue to hear from our members on these issues.

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Inconsistent Application of NCUA's Regulations

One of the most troublesome complaints we hear is that NCUA examinations continue to be applied inconsistently. While we fully recognize that examiners must have a certain degree of discretion, as we have previously communicated to the agency, inconsistent examinations and application of regulations create unnecessary confusion and are costly. For various prudent reasons, credit unions communicate with other credit unions as part of their overall regulatory compliance strategy. This type of cooperation is an extension of credit unions' cooperative model, and in some cases, helps credit unions save resources that otherwise would have to be expended on regulatory compliance.

Unfortunately, however, if examinations are not applied consistently, compliance with the ever-growing number of regulations will be ever more difficult. As a significant percent of examiners are new and with a large number retiring, NCUA will no doubt be continuing to hire new examiners. Thus, we believe that this is a critical juncture, as well as a great opportunity, for the agency to ensure that it appropriately trains and educates examiners so that examinations are conducted consistently. We ask that NCUA take any and all measures it deems appropriate to achieve this goal.

Guidance vs. Regulation

It continues to be unclear as to what level of deference should be given to an examiner's recommendation based on existing guidance, versus the level of deference given to a finding based on the violation of an actual regulation. NAFCU believes that it should be clear in an examination report what constitutes a recommendation as opposed to what is an actual finding. There is a clear legal distinction, and NAFCU has heard that many examiners blur the two.

Concentration Risk

In a recent letter to you regarding NCUA's careful examinations of credit unions portfolio for concentration risk, NAFCU expressed concern about credit unions being forced to divest assets. In a letter dated August 10, 2010, you kindly responded to NAFCU's letter, in which you explained that Letter to Credit Unions 10-CU-03 "does not prescribe a specific course of action to resolve elevated levels of risk, but rather offers several alternatives for management and examiners related to controlling and reducing concentration risk." You also stated that "It is the examiner's job to review the risk monitoring and mitigation strategy and determine the reasonableness in relation to exposure to the NCUSIF. This is a function examiners will continue to perform in order to protect the NCUSIF and minimize future risk of loss that is borne by all credit unions."

NAFCU would like to, first of all, thank you for taking time to respond to our letter. We agree with your statements regarding examiners role in determining the

reasonableness of the credit union's risk position in relation to exposure to the NCUSIF, and that such is a function that examiners perform and continue to perform.

While we agree with those statements and positions, NAFCU remains concerned that the examination guidance can be improved and examiners' analysis can be strengthened and be more helpful if examiners are specifically instructed to take into careful consideration the consequences of the course of action they ultimately force credit unions to take, both on the credit union and the NCUSIF. Also, an examiner's analysis should include a credit union's expertise and experience in a particular line of products in consideration of the appropriateness of the credit union's risk management practices.

NCUA's Resolution of Conserved Credit Unions

One of the most unfortunate and regretful consequences of the post-2007 financial crisis is that many credit unions have been placed under conservatorship by NCUA and many have been liquidated. Throughout the crisis, NCUA has used its various resolution authorities to address credit unions that have been determined to no longer be viable.

NAFCU understands that actions relative to resolutions are never easy or simple. As is the case with other areas of regulations, however, credit unions and the industry as a whole would greatly benefit from well-crafted documents that contain helpful information about the resolution tools available to the NCUA and more importantly, the process that NCUA follows to address "problem" credit unions. Accordingly, NAFCU encourages the agency to publish a handbook on NCUA's resolution process similar to the Federal Deposit Insurance Corporation's (FDIC) Resolution Handbook, which is available to the public at http://www.fdic.gov/bank/historical/reshandbook/index.html. In addition, we believe that NCUA should publish more information about NCUA's Asset Management and Assistance Center. We understand that AMAC publishes available assets for sale on the NCUA website, but more information on how the facility manages assets and what its role is relative to the share insurance fund would be helpful.

Capital Requirements and Prompt Corrective Action

August 2010 marked the 10th year anniversary of the effective date of the capital requirements and prompt corrective action (PCA) for federally insured credit unions under the Credit Union Membership Access Act of 1998. During this period, credit unions have placed great emphasis on adequacy of capital and many maintain a level of capital that far exceeds that which is required under the law. For some, however, despite their efforts, maintaining capital levels to remain well-capitalized has become unattainable due to significant losses attributed both to NCUA-imposed assessments and to losses in their asset portfolio.

One of the important aspects of the credit union PCA regime is that, while it establishes net worth requirements, it provides NCUA significant flexibility. For example, in regard to credit unions that are undercapitalized, NCUA may "(A) appoint a

conservator or liquidating agent for the credit union; or (B) take such other action as the Board determines would better achieve the purpose of this section, after documenting why the action would better achieve that purpose." *See* 12 U.S.C. § 1790d(i).

NCUA has even greater flexibility in regards to actions it can take if a credit union's CAMEL rating drops. This is because unlike the PCA, the CAMEL rating system it is an internal one that NCUA uses to evaluate a credit union's soundness. *See* NCUA's Letters to Credit Unions 07-CU-12. Specifically, the FCU Act does not require that NCUA take any specific action if a credit union's CAMEL rating changes. By the same token, the Act does not specifically limit how much flexibility the agency has to take particular action in such cases.

NAFCU strongly urges the NCUA to fully utilize the flexibility it is afforded by law and choose the least drastic measures available to it when a credit union's net worth drops the credit union into a lower net worth category or if its CAMEL rating declines. As credit unions continue to negotiate the most difficult economic times since the Great Depression, we believe such a restraint is in the best interest of the NCUA, the National Credit Union Share Insurance Fund (NCUSIF), the credit union industry as a whole, and most importantly the 92 million credit union members in our nation that rely on their credit unions.

Diversifying Liquidity Sources

NAFCU believes that credit unions should be encouraged to utilize all available sources of funding. As NCUA is aware, there a number of sources of liquidity that credit unions are tapping into, including corporate credit unions, Federal Home Loan Banks (FHLBs) and the Central Liquidity Facility (CLF). Because of relationships established over years, credit unions are familiar with corporates and generally understand how to access liquidity through their corporates. On the other hand, while the CLF is not a lender of "last resort," credit unions may not use it as a conventional funding facility or standard market alternative.

An effective option, especially as regard to interest rates, which is available for credit unions, is the use of the FHLBs sources. If managed properly, advances from FHLBs would enable credit unions to appropriately diversify funding sources. At the same time, utilizing this avenue would reduce the risk of loss.

Unfortunately, however, we have found that many credit unions are not adequately familiar with FHLBs to effectively use them. Accordingly, we believe, that NCUA should issue a Letter to Credit Unions on use of FHLBs as a proper source of funding. As many credit unions lack the resources or expertise to obtain appropriate information, NAFCU believes that information on FHLBs sources of funding that is appropriately tailored for federally insured credit unions would be greatly useful to many in the industry. NCUA's role as credit unions' safety and soundness regulator places it in the ideal position to issue such information.

Mergers

For a number of years, NAFCU has consistently encouraged NCUA to improve the agency's merger and purchase and assumption process. We have urged for transparency, improved accessibility of information for credit unions interested in merging, and changes to the substantive regulatory requirements involved in merger transactions. Thus, we applaud and welcome the agency's imminent consolidation of the regional databases that contain merger information for credit unions interested in mergers.

While the consolidation of the databases should be a helpful step, we believe that NCUA should continue to review its merger manual and the overall credit union merger process to eliminate unnecessary obstacles. Further, we strongly urge NCUA to ensure that the merger process, in its entirety, is fully transparent. Importantly, potential partners should be provided complete information to enable them to make sound business decisions.

Hart-Scott-Rodino Pre-merger Notification Requirements

Another ongoing issue that NAFCU has advocated for is the exemption of credit unions from the premerger notification requirements under the Hart-Scott-Rodino Act. By way of background, the Hart-Scott-Rodino Act requires a merging entity, including a FCU, must comply with the Act's premerger notification requirements if the merger exceeds a threshold established by the Federal Trade Commission. FTC is authorized to prescribe regulations to "exempt, from the requirements of [the premerger notification requirements], classes of persons, acquisitions, transfers, or transactions which are not likely to violate antitrust laws." *See* 15 U.S.C. § 18a(d)(2)(B).

NAFCU does not believe that mergers between federal credit unions that require approval by NCUA are likely to violate antitrust laws regardless of how an antitrust market analysis reasonably defines the market. Credit union mergers must meet stringent statutory and regulatory requirements, including narrowly tailored rules related to persons that merging FCUs can serve.

The Act also provides an exemption from pre-merger notification requirements for mergers between depository institutions that require approval from the Office of the Comptroller of Currency (OCC), the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, or the Office of Thrift Supervision (federal banking agencies). *See* 16 U.S.C. § 18a(7). The merging entity, however, is required to provide a copy of the material it submits to the FTC as well as the U.S. Department of Justice. *Id.* § 18a(6); see also 16 C.F.R. § 802.6.

It is our understanding that the exemption for banks has been acceptable for both the FTC and the DOJ because the federal agency approval for such bank mergers requires the approving agency to conduct an analysis of whether the transaction raises antitrust or

anti-competition concerns. NCUA does not impose a similar requirement for credit union merger approval, but we also do not think that it is necessary or advisable because of the not-for-profit nature and unique mission of credit unions. The lack of such requirement, thus, should not be grounds on which to decline the exemption for credit union mergers we request today.

I would like to respectfully request that NCUA engages the FTC regarding the exemption of credit union mergers. NAFCU has been strongly urging the FTC to prescribe rules exemption credit union mergers. We have also communicated our concerns with members of Congress and pursuing an amendment from the Hart-Scott-Rodino Act that would exempt credit unions from the FTC's premerger notification requirements (see attached letter).

It is NAFCU's opinion that credit union mergers do not generally pose antitrust or anticompetitive concerns. If, however, the NCUA disagrees or if NCUA has concerns that possible scenarios exit that will raise antitrust concerns, we believe the antitrust analysis should be conducted by NCUA as part of NCUA's merger approval process. Thus, we ask that NCUA actively seeks the exemption for credit unions, either by a statutory amendment or a regulatory action.

Exemption from SEC's Broker-Dealer Registration Requirement

As NCUA is aware, nearly three years ago, the Securities and Exchange Commission (SEC) and the Federal Reserve System (Board) issued a joint final rule implementing exceptions for banks from the definition of the term "broker" under Section 3(a)(4) of the Securities Exchange Act of 1934, as amended by the Gramm-Leach-Bliley Act (GLBA). The final rule implements broker exceptions for banks relating to third-party networking arrangements, trust and fiduciary activities, sweep activities, and safekeeping and custody activities. GLBA provides explicit exemptions from registering with the SEC. The same explicit exemption is not provided to credit unions, even though FCUs are permitted to engage in securities-related activities addressed in the final rule under Section 107 of the Federal Credit Union Act and regulated by the NCUA. Without the same exemptions given to "banks," credit unions will be dissuaded from providing services which consumers demand, putting credit union members at a disadvantage.

NAFCU understands that NCUA was engaged in discussions with the SEC immediately before the current financial crisis took center stage. While we are aware that NCUA plans to issue a Letter to Credit Unions on this issue, and will hopefully be helpful in helping credit unions understand what is involved, we maintain our position that an explicit exemption by SEC regulation is still necessary to avoid any doubt about the various registration requirements and to achieve parity with banks.

Today, we specifically request that NCUA re-engage the SEC regarding the extension of the broker exemptions to credit unions. As credit unions, and the country as

a whole, emerge from the Great Recession, NAFCU believes it is imperative that all possible actions are taken by regulators to facilitate the provision of high quality financial services by credit unions. Extending the broker exemption to credit unions is action that can readily be taken.

Member Business Loans

As you know, NAFCU strongly believes that the statutory cap on member business lending (MBL) is arbitrary and should be removed or increased. We appreciate your active support to accomplish the legislative changes necessary to increase the statutory cap on MBL and strongly encourage the agency to continue its work in this regard.

In the meantime, however, NCUA should not overlook its existing regulatory authority to facilitate and encourage increased involvement in business lending. As we have previously, we offer the following recommendations.

Loan-To-Value Requirement

NCUA imposes a loan-to-value (LTV) requirement of 80% on most secured MBLs. We recommend that NCUA relaxes this restriction under certain circumstances.

Specifically, we believe that the LTV for MBLs should be modified to allow credit unions to issue loans at higher than 80% LTV if they have demonstrated that they have adequate capital, expertise and ability to assess risks on MBLs they issue. These qualities diminish the necessity for imposing the LTV requirement on these credit unions. We recommend that the NCUA make changes to the provisions on the LTV requirements so that credit unions that can demonstrate they have adequate capital and expertise, such as those that qualify for Regulatory Flexibility (RegFlex) programs under Part 742 of NCUA's regulations, may offer MBLs with LTV ranges from 85% to 95%.

We also urge the agency to revise its regulations so that the general LTV requirement of 80% applies to all MBLs, including construction and development loans. Current regulations impose a 75% LTV on construction and development loans on the basis of NCUA's reasoning that such loans pose increased risk. We have heard from our members, however, that the 5% variation does not make a valuable difference in terms of risk. On the other hand, it places credit unions in further competitive disadvantage while also creating confusion.

NAFCU understands that there are sound policy reasons for imposing an LTV requirement on MBLs. We, however, believe that sound policymaking related to MBLs must take into account that significant restrictions on MBLs place credit unions in competitive disadvantage because other financial institutions' business lending practices are significantly less restricted. Modifying the LTV requirement could reduce the disadvantages facing credit unions.

Vehicle Lending and MBLs

Under current regulations, LTV requirements do not apply to loans secured by consumer type vehicles, provided that the vehicle is not part of a fleet. NCUA policy defines fleet to generally mean two or more vehicles used in a business that requires the use of multiple vehicles. NCUA's regulations are grounded on the notion that vehicles used for businesses depreciate in value more quickly than consumer type vehicles.

NAFCU strongly urges the NCUA to modify its policy on fleet vehicles. The present policy on fleet vehicles does not sufficiently take into account many facts and circumstances which should reshape NCUA's approach to regulating in this field.

Vehicles Not Used for Revenue-Generating Purposes

Current NCUA policy focuses only on the member-business itself. We believe that the NCUA should also consider use of the vehicle for which the member is obtaining the loan. For example, where a vehicle is not used for the purpose of generating revenue for the member, it should not be considered as part of a fleet of vehicles. Vehicle loans involving a member-business that offers its employees the use of a vehicle for personal purposes should not be considered part of a fleet. Or, if a partnership made up of five persons would like to buy a vehicle for each partner, these would be eligible for 100% financing. Modifying the rule so that only vehicles used for generating revenue are considered part of a fleet would enable more members to benefit from products and services their credit union offers without increasing the risk in the MBL portfolio.

As an alternative, we recommend that where the vehicles are not used for revenue generating purposes by the member-business, the credit union be allowed to make loans on at least five vehicles without the loans being considered MBLs.

Risk Mitigated By Short Term Loans

We also believe that the LTV requirement should not be imposed on vehicle loans with terms of 48 months or less. The purpose of the LTV requirement for vehicles used for business is to guard against the increased risk posed by the more rapid depreciation of collateral. However, where asset quality is less likely to be compromised, as in the case where the loan must be repaid within 48 months or shorter, imposing the LTV requirement would be without purpose. We believe the speed of principal reduction on a 48 month loan mitigates the concern of increased risk. Thus, these short term loans should be eligible for 100% financing.

Vehicle Loans to Not-for-Profit and Government Entities

The current NCUA policy unnecessarily restricts not-for-profit, governmental and other civil service entities' ability to benefit from borrowing at lower cost from credit

unions. This barrier, although unintended, should be removed. We believe that credit union lending to such entities should be encouraged and not restricted by regulation.

In order to address this matter, NAFCU recommends that the NCUA provide an exception to its fleet vehicle policy for vehicle loans to not-for-profit, governmental and other civil service entities. Credit unions' ability to better serve the needs of these entities would greatly benefit communities across the country because it would make financial sense for such organizations to borrow at lower cost, thus bolstering these entities' ability to achieve their benevolent purposes.

Applying for Waivers

Current regulations require a credit union to submit supporting documentation as well as explanations for the waiver being sought. Additionally, a decision on the request need not be rendered for 45 calendar days after the request has been submitted.

NAFCU strongly believes that the ability for credit unions to obtain a waiver must not only be preserved, but the process must be improved so that the option is attractive for credit unions. While the waiver option provides an important opportunity for credit unions to improve their MBL programs, we are convinced that the process, as it presently exists, is inefficient. Also, our members have conveyed to us that the existing process and standards have been inconsistently applied. Consequently, many credit unions do not pursue a waiver.

To make the option to seek a waiver more attractive for credit unions, the requirements should be reduced and the application process streamlined. Specifically, the NCUA should eliminate the requirement for analysis of prior experience under § 723.11(e). We believe that documentation showing ability to manage the activity under § 723.11(d) should be adequate for the NCUA Regional Director to make a determination on a waiver request. We also encourage the NCUA to reduce the 45 days response time to 20 calendar days.

Further, NCUA should provide an alternative application process for credit unions that meet RegFlex standards. Such credit unions have demonstrated superior performance and are less likely to increase unreasonable risk to the credit union and the industry. As such, we believe that neither the documentation requirement under § 723.11(d) nor the analysis called for under § 723.11(e) should be imposed on these credit unions. Further, the response time for their requests should be reduced to 10 calendar days so that they can proceed with their loan determinations.

Loan Participations

NCUA regulations provide instructions on how credit unions should account for MBL participations and how the participations affect the credit union's MBL limit. *See* 12 CFR § 723.1(d), 723.1(e) and 723.16(b). NAFCU strongly recommends that the

NCUA amend these sections to clearly state NCUA's policy that MBL participations do not count against the credit union's MBL cap. MBL participations have distinct characteristics that differ from regular member business loans that the credit union issues to its own member-businesses. MBLs pose different risks from MBL participations and, consequently, should not be grouped together.

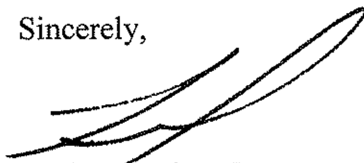
Accordingly, the NCUA should make necessary changes to its regulations to ensure that MBL participations and MBLs are not only accounted for separately, but also that participations are not aggregated with member business loans. We believe that credit union members would be the ultimate beneficiaries from this clarification.

MBL Maturity Dates

Currently, MBLs secured by real estate may not have maturity that exceeds fifteen (15) years. NAFCU would like to take this opportunity to call on NCUA to pursue broad statutory authority to establish maturity limits for all business loans. In this regard, we note that the current limit on MBLs secured by real estate is inappropriate because it reduces choices for member businesses. At the same time, it stifles credit unions' ability to sell these loans in the secondary market.

I look forward to hearing from you regarding these important matters. Should you have any questions or would like to discuss these issues further, please contact Tessema Tefferi NAFCU's Associate Director of Regulatory Affairs, by telephone at (703) 842-2268 or by e-mail at ttefferi@nafcu.org or me by telephone at (703) 842-2215 or my e-mail at fbecker@nafcu.org.

Sincerely,



Fred R. Becker, Jr.
President/CEO

cc: Board Member Gigi Hyland
Board Member Michael E. Fryzel

Chairman Matz -
We sincerely hope
that the agency will
help resolve some of these
issues to further
enhance the examination
process!