American Bankers Association
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Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

re: National Credit Union Administration; Eligible Obligations, Charitable Contributions, Nonmember Deposits, Fixed Assets, Investments, Member Business Loans, and Regulatory Flexibility Program; 12 C.F.R. Parts 701, 703, 723, and 742; 76 Federal Register 81421, December 28, 2011

Dear Ms. Rupp:

The National Credit Union Administration (NCUA) Board (the Board) proposed a rule extending regulatory relief to all federal credit unions (FCUs) to engage in activities that were previously only granted to FCUs that had received Regulatory Flexibility (RegFlex) designation – FCUs that are well-capitalized and are not supervisory concerns. As a consequence, this proposed rule will extend certain regulatory authorities to undercapitalized and weak FCUs.

The proposed rule would abolish Section 742, which deals with RegFlex authorities; would eliminate the charitable contributions and donation rule; and would ease regulatory requirements on certain rules dealing with nonmember deposits, fixed assets, and investments.

While the American Bankers Association (ABA)[1] is supportive of efforts to lower regulatory burdens, ABA believes that it is inappropriate to extend such regulatory relief to FCUs that are undercapitalized or represent supervisory concerns. Specifically, ABA believes the Board should not expand the authorities of undercapitalized FCUs by allowing them to invest in undeveloped land or accept nonmember deposits. Such an expansion could jeopardize the viability of an undercapitalized FCU and pose a risk to the National Credit Union Share Insurance Fund (NCUSIF). Additionally, ABA believes the Board should retain its charitable contribution and donation rule, which it is proposing to eliminate.

Background

In 2002, the Board established the RegFlex program for FCUs. Since then, the Board has amended its RegFlex rules on four different occasions, such as expanding the list of activities for

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13.8 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities.

FCUs not subject to regulatory restrictions, reducing the criteria for obtaining RegFlex status, and enhancing safety and soundness for FCUs by retracting some RegFlex provisions.

An FCU qualifies for RegFlex designation when it has received a composite CAMEL rating of "1" or "2" during its last two examinations and has maintained a net worth classification of "well capitalized" for the last six quarters. If an FCU is subject to a risk-based net worth (RBNW) requirement under part 702, it also qualifies for RegFlex treatment when it has remained "well capitalized" for the last six quarters after applying the applicable RBNW requirement. An FCU that does not automatically qualify may apply for a RegFlex designation with the appropriate regional director. As of June 30, 2011, 61 percent of FCUs (2,764 FCUs out of 4,534 FCUs) had RegFlex designation.

The proposed rule would extend regulatory relief to the remaining 1,770 FCUs by abolishing Section 742, which deals with RegFlex authorities. The proposed rule would also eliminate the charitable contributions rule and provide regulatory relief to rules dealing with eligible obligations, nonmember deposits, fixed assets, and investments.

ABA's Position

While ABA supports efforts to lower regulatory burdens, ABA believes that it is not appropriate to extend such regulatory relief to FCUs that are **undercapitalized** or **represent a supervisory concern**, as it may increase the risk to the NCUSIF. ABA believes that the proposed changes to NCUA regulations with regard to nonmember deposits and fixed assets should **not** be extended to undercapitalized credit unions. In addition, while ABA supports the right of FCUs to make charitable contributions and donations, ABA disagrees with the Board over its proposal to eliminate NCUA's charitable contributions rule.

Nonmember Deposits

The Federal Credit Union Act permits an FCU to accept deposits from an officer, employee, or agent of those nonmember units of Federal, Indian Tribal, State, or local governments and political subdivisions.[2] NCUA is proposing to modify the amount of nonmember deposits that an FCU may accept.

Under current regulations, an FCU may accept nonmember deposits up to 20 percent of total shares or $1.5 million, whichever is greater. Credit unions that have a RegFlex designation are currently exempt from this requirement.

NCUA is proposing to eliminate the RegFlex nonmember deposit exemption and modify the amount of nonmember deposits that an FCU can accept to 20 percent of total shares or $3 million, whichever is greater.

NCUA believes that the proposal provides the regulatory relief to all FCUs without adversely affecting RegFlex designated credit unions, as only 4 RegFlex FCUs currently exceed the limitation of 20 percent of total shares or $1.5 million in nonmember deposits, whichever is

[2] Federal Credit Union Act, Section 1757(6)

greater. The Board states that raising the threshold to $3 million will benefit small credit unions with less than $7.5 million in shares. In fact, the higher proposed *de minimis* threshold would benefit any FCU with less than $15 million in total shares.

ABA is appreciative of NCUA's efforts to require **all FCUs** to be subject to nonmember share limits. ABA agrees with NCUA that nonmember and public unit shares are not core deposits and are more volatile than core member shares. There is a greater potential for the credit union to be subject to increased stress if these funds suddenly depart the credit union, especially if these funds are a large component of the credit union's source of funds.

Evidence shows that nonmember deposits have played a role in credit union failures and imposed significant losses on the NCUSIF.[3] Several recent high profile credit union failures arose from the use of nonmember deposits to fund rapid asset growth.

For example,

- HeritageWest FCU reported that nonmember deposits went from zero as of March 2007 to $52.1 million as of March 2009. This expansion in nonmember deposits supported rapid asset growth at the credit union with almost half of the credit union's asset growth funded by nonmember deposits. At the time HeritageWest was closed, it reported $48 million in nonmember deposits, which comprised over 17 percent of its total deposit base.

- The Material Loss Review of Beehive Credit Union found that management did not effectively plan, manage, or control liquidity risk. The report noted that high-cost nonmember deposits rose to 18 percent of total deposits.[4]

- The Material Loss Review of the failure of Norlarco Credit Union found that "there was no policy that set parameters to limit risk or that required management to report asset sales, borrowing activity, or use of nonmember deposits to help fund the $30 million per month loan commitment."[5]

However, ABA does not believe the proposed rule goes far enough.

First, ABA believes that a large influx of nonmember deposits, which may arise from raising the *de minimis* threshold from $1.5 million to $3 million in nonmember deposits, could create asset/liability management and liquidity concerns for some small credit unions. These FCUs may not have the necessary plans, practices, and experience to manage such an inflow of deposits. ABA recommends that the Board require any small credit union that wishes to take advantage of the higher *de minimis* threshold of $3 million have adopted policies managing the risk associated with nonmember deposits.

[3] NCUA in 1988 issued an Interim Final Rule after it was discovered that the amount of nonmember deposits far exceeded what was needed to meet members needs and were used to fund high risk loans and questionable investments. (Federal Register, December 19, 1988, 50918).
[4] http://www.ncua.gov/about/Leadership/CO/OIG/Documents/OIG201107MLRBeehiveCU.pdf
[5] http://www.ncua.gov/about/Leadership/CO/OIG/Documents/OIG200901MLRNorlarco.pdf

Second, although NCUA's Prompt Corrective Action (PCA) regulations (Section 702.202) specifies that the prohibition on accepting nonmember deposits is a discretionary supervisory action for NCUA, ABA recommends that undercapitalized credit unions should be prohibited from accepting or rolling over nonmember deposits. This would be consistent with the Federal Deposit Insurance Corporation's brokered deposit rule. Additionally, FCUs that are less than well capitalized should be subject to the high interest rate limitations, where rates the credit union pays on shares are restricted to the prevailing rates paid on comparable accounts and maturities in the relevant market area. This too is consistent with rules that apply to banks.

Fixed Assets

In 2009, NCUA expanded the partial occupancy requirement from three to six years when a RegFlex designated FCU acquires unimproved land. The Board noted that when an FCU is acquiring unimproved land the partial occupancy requirement is more difficult to satisfy than if the FCU were purchasing premises with an existing branch building.

The Board is now proposing to extend this requirement to all FCUs. However, ABA questions the wisdom of allowing an undercapitalized FCU to acquire undeveloped land for future expansion, as well as extending the partial occupancy requirement from three to six years. ABA believes that the acquisition of undeveloped land would be inconsistent with NCUA's PCA regulation, especially with regard to the implementation of an undercapitalized FCU's net worth restoration plan. Since FCUs can only build net worth through retained earnings, allowing an undercapitalized FCU to invest in unimproved land would reduce its earning assets at the very moment that it needs earnings, making it more difficult for an undercapitalized FCU to restore itself to well-capitalized status.

In fact, NCUA wrote in 2010 "that investing in higher levels of non-earning assets can materially affect a credit union's earnings ability and, therefore, its viability."[6] So, allowing an undercapitalized FCU to invest in undeveloped land could pose a risk to the NCUSIF.

Therefore, ABA urges the Board not to extend the partial occupancy requirement for unimproved land for undercapitalized FCUs. In fact, ABA believes NCUA should not allow undercapitalized FCUs to invest in undeveloped land, as it could materially impact the viability of the FCU.

Charitable Contributions and Donations

ABA supports the right of FCUs to make charitable contributions and donations; but believes the Board proposal to eliminate its charitable contribution and donation rule is bad policy. The board of directors of a FCU should have a say regarding charitable contributions and donations. FCU members should know how their funds are being used. ABA urges the Board to retain its current charitable contributions and donations rule.

Currently, NCUA's charitable contributions and donations rule (12 CFR Section 701.25) states:

[6] Federal Register, March 25, 2010, p. 14373.

(a) A federal credit union may make charitable contributions and/or donate funds to recipients not organized for profit that are located in or conduct activities in a community in which the federal credit union has a place of business or to organizations that are tax exempt organizations under Section 501(c)(3) of the Internal Revenue Code and operate primarily to promote and develop credit unions.

(b) The board of directors must approve charitable contributions and/or donations, and the approval must be based on a determination by the board of directors that the contributions and/or donations are in the best interests of the federal credit union and are reasonable given the size and financial condition of the federal credit union. The board of directors, if it chooses, may establish a budget for charitable contributions and/or donations and authorize appropriate officials of the federal credit union to select recipients and disburse budgeted funds among those recipients.

But RegFlex FCUs are currently exempt from the charitable contributions rule.

NCUA is proposing to abolish its rule regarding charitable contributions and donations so that any FCU can make donations without the prior approval of its board of directors and without regulatory restrictions as to recipients.

This represents a 180 degree change in position for the Board. NCUA previously commented it was "not convinced that this exemption should apply to all credit unions. The donation of a credit union's members' money to an outside party is a highly sensitive issue."[7] The Board believed that its charitable contribution and donation rule protected the interests of members and avoided conflicts of interest at FCUs that did not qualify for Reg Flex designation.

The Board now believes there are sufficient safeguards to limit these abuses. Its incidental powers authority dictates that such donations and contributions must be necessary or requisite to enable the FCU to effectively carry on its business. NCUA notes that FCU directors have a fiduciary duty to direct management to operate within sound business practices and the best interests of the membership. Also, FCU Bylaws prohibit conflicts of interest that could arise in the context of making charitable donations.

Despite these assurances, ABA believes that NCUA should retain its charitable contribution and donation regulation and the regulation should apply to all FCUs. As ABA wrote NCUA on May 22, 2000:

> "ABA believes that the credit union's board of directors should determine the nature and size of charitable contributions to be made by the credit union. While the board would not necessarily have to vote on each charitable donation, the board should have a clearly articulated policy with regard to charitable contributions. The members of the board of directors are the elected representatives of the member owners, not management. To give management the discretion to make such determinations would erode the members' control over the credit union. Many times the interests of management are not aligned with the interests of the owners/members, thereby creating principal-agent conflicts.

[7] Federal Register, November 23, 2001, p. 58659.

> Additionally, NCUA should retain the requirement that limits recipients to charitable donations to organizations located in or conducting activities in a community in which the FCU has a place of business, particularly since credit unions are not subject to the Community Reinvestment Act."

ABA requests that NCUA retain its charitable contribution and donation rule. This rule acted to protect the interests of members and avoid conflicts of interest.

Conclusion

ABA believes that it is inappropriate to extend regulatory relief to FCUs that are undercapitalized or represent supervisory concerns. Specifically, ABA believes the Board should not expand the authorities of undercapitalized FCUs by allowing them to invest in undeveloped land or accept nonmember deposits. Such an expansion could jeopardize the viability of an undercapitalized FCU and pose a risk to the NCUSIF. Additionally, ABA believes the Board should retain its charitable contribution and donation rule, which it is proposing to eliminate. Its current charitable contribution rule acts to protect the interests of members and avoid potential conflicts of interest.

If you have any questions, please feel free to contact the undersigned.

Sincerely,

Keith Leggett
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