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January 28, 2003

Ms. Becky Baker
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: National Credit Union Administration; Prompt Corrective Action: Proposed Abbreviated Net Worth Restoration Plan; 12 CFR Part 702; 67 Federal Register 71113; November 29, 2002

Dear Ms. Baker:

The National Credit Union Administration (“NCUA”) has requested comments “on a proposal to allow an abbreviated net worth restoration plan for qualifying credit unions whose net worth has declined marginally below 6 percent because of growth in assets outpaced growth in net worth.” Credit unions compete directly with community banks and savings associations, but credit unions do not pay federal and, in general, state income taxes. The American Bankers Association (“ABA”) brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country. ABA can be found on the Internet at www.aba.com.

General Comments

Under the NCUA’s prompt corrective action (“PCA”) statute,¹ the NCUA proposes to allow credit unions that have dropped below the level of net worth to qualify for “adequately capitalized” to file an abbreviated net worth restoration plan if the credit union is only “marginally” undercapitalized and if the undercapitalization resulted from “uninduced” share growth. The abbreviated net worth restoration plan would be simpler to file than the real net worth restoration plan and would allow the credit union to continue to grow, even though its growth was “uninduced.” The American Bankers Association concludes that the NCUA’s proposal is simply designed to allow the NCUA to let some undercapitalized credit unions continue to grow their assets, despite the statutory restrictions on undercapitalized insured institutions’ asset growth. Therefore, the ABA concludes that the NCUA’s proposal goes beyond its statutory authority, and it should not be adopted.

¹ 12 USC 1790d.

Background

To be eligible to file an abbreviated 1st tier net worth restoration plan (“NWRP”), the proposed rule establishes historical net worth, performance, and growth criteria. According to the Board, the eligibility criteria “qualify only those credit unions that historically are profitable and have become marginally ‘undercapitalized’ primarily because of uninduced share growth.”² To be eligible, a credit union must meet some special net worth criteria. First, a credit union must have a minimum net worth ratio of 5.50% as measured using the quarter-end balance of total assets per §702.2(k)(1)(iv). That is, it must be undercapitalized but not too undercapitalized that no reasonable assumptions would allow the NCUA to let the institution continue growing. Second, for each of the three prior quarters, a credit union must have achieved a net worth ratio of at least 6 percent. Third, a credit union also must meet a performance criterion: for the current and each of the three preceding quarters, a credit union must have increased the dollar amount of its net worth by 60 basis points (0.60 percent) annual return on average assets (“ROAA”). Fourth, a credit union must meet a growth criterion: for the period combining the current and three preceding quarters, ending total asset growth may not exceed 110% of the growth in net worth plus shares and deposits. In other words, the difference in total assets cannot exceed the difference in net worth plus shares and deposits by more than 10 percent. A credit union that grows substantially through borrowings will be required to file a standard NWRP.

If a credit union is eligible to file a 1st tier net worth restoration plan, the proposed rule greatly simplifies the filing requirements on the institution. First, a plan must include a realistic pro forma projection of growth in total assets, shares, ROAA and net worth ratio over the next four quarters, that will result in a net worth ratio of at least 6 percent and meet any applicable Risk Based Net Worth requirement. Second, a plan must include a statement describing how the credit union will control exposure to market and institution risks arising from any new activities that it plans to undertake over the next four quarters. Notably absent is a requirement that the credit union show how it will restrict its “uninduced” growth. It is also significant that the proposal provides that if, within four quarters, a “marginally”³ undercapitalized credit union has not become adequately capitalized, then the credit union will be required to file a standard net worth restoration plan. ABA notes that this then would be the start of the process that currently would apply to these institutions, except that the institution has been allowed to continue its growth for a year after becoming undercapitalized from “uninduced” growth.

Analysis

As ABA stated in its July 2, 2002 letter, the NCUA’s PCA statute provides that “The purpose of this section is to resolve the problems of insured credit unions at the least possible long-term loss to the Fund.” To that end, the statute requires that the NCUA “shall, by regulation, prescribe a system of prompt corrective action for insured credit unions that is--(i) consistent with this section; and (ii) comparable to section 1831o of this title. “Section 1831o of this title” is the PCA statute governing

² ABA finds the NCUA’s concept of “uninduced growth” somewhat illogical. Surely one of the few things truly controllable by a financial institution is the ability to limit too rapid growth. On the other hand, if the institution opens its doors, advertises rates of interest paid for deposit, and otherwise operates like a financial institution, it must be thought of as “inducing growth.” However, once one realizes that undercapitalized institutions must be restricted from unsafe asset growth, the reason behind the NCUA’s creating such a concept as “uninduced growth” begins to appear.

³ We note that the proposal allows a credit union to be undercapitalized by .5% of net worth, or to have a 5.5% net worth ratio rather than the 6% required of an adequately capitalized institution, or less than 92% of the required minimum to be adequately capitalized. The NCUA’s idea of “marginally” undercapitalized is somewhat larger than ABA’s.

banks, contained in the Federal Deposit Insurance Act. It requires, among many things, that an undercapitalized institution be restricted from asset growth except in rather narrow circumstances.⁴ In fact, all of the following restrictions must apply:

- (i) Restricting payment of capital distributions and management fees (section 38(d));
- (ii) Requiring that the FDIC monitor the condition of the bank (section 38(e)(1));
- (iii) Requiring submission of a capital restoration plan within the schedule established in this subpart (section 38(e)(2));
- (iv) Restricting the growth of the bank's assets (section 38(e)(3))** (emphasis added); and
- (v) Requiring prior approval of certain expansion proposals (section 38(e)(4)).

Thus, the intention of Congress is made quite clear that, if an institution fails to meet the criteria for being at least adequately capitalized, its asset growth is to be limited.

What restrictions does the NCUA place on asset growth of an institution that is no longer adequately capitalized from “uninduced” growth? The NCUA states hypothetically that “[t]ogether, these eligibility criteria would allow **57.25% annualized asset growth for one quarter** [emphasis added], causing a credit union’s net worth ratio to fall from 6 percent to 5.50 percent, provided that its ROAA is 60 basis points. ABA notes that a 57.25 percent annualized rate of growth represents growth of approximately 12 percent, compounded, per quarter from “uninduced” growth.

Frankly, ABA does not believe that an annualized growth rate of 57.25 percent meets the objective of restricting growth, particularly when it is “uninduced” and apparently beyond the control of the institution. Congress, by its action, obviously felt that such growth by an undercapitalized institution could pose significant risk to the National Credit Union Share Insurance Fund (“NCUSIF”). ABA questions whether an institution growing that rapidly from “uninduced” growth has adequate internal risk controls to manage such rapid growth. Since the purpose of prompt corrective action is to limit the risk exposure of the NCUSIF, a further curb on such growth should be put in place for a credit union to be eligible to file a 1st tier NWRP. That actual curb is in place now, under the requirements for filing a real net worth restoration plan, rather than the proposed abbreviated one.

ABA notes further that the NCUA states that “a credit union that succeeds in restoring its net worth in the second quarter of a 1st tier NWRP, and that stays ‘adequately capitalized’ for the third and fourth quarters of the plan, will become eligible, in the first quarter after that plan ends, to file another 1st tier NWRP if it declines below ‘adequately capitalized.’ By the quarter after the original 1st tier NWRP ends, that credit union will have been ‘adequately capitalized’ in each of the three preceding quarters.” ABA believes this provision is at odds with purpose of the prompt corrective action requirements. If a credit union becomes undercapitalized shortly after restoring itself to being adequately capitalized, this raises questions about the “realistic assumptions” and success of

⁴ Sec. 1831o. Prompt corrective action

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(e) Provisions applicable to undercapitalized institutions

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(3) Asset growth restricted

An undercapitalized insured depository institution shall not permit its average total assets during any calendar quarter to exceed its average total assets during the preceding calendar quarter unless--

(A) the appropriate Federal banking agency has accepted the institution's capital restoration plan;

(B) any increase in total assets is consistent with the plan; and

(C) the institution's ratio of tangible equity to assets increases during the calendar quarter at a rate sufficient to enable the institution to become adequately capitalized within a reasonable time.

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the net worth restoration plan to restoring the credit union to being adequately capitalized in the first place. In such an instance, the obvious fact is that the credit union's abbreviated NWRP failed. After all, to file another abbreviated NWRP, the credit union must still be suffering "uninduced" growth, even though it has had 15 months to get over its "uninduced" growth.

Conclusion

ABA was the only commenter on the original ANPR on this proposal to tell the NCUA that its proposal appeared to violate the PCA restrictions on asset growth of undercapitalized credit unions. After reviewing this current proposal, it appears that we were correct. ABA believes that NCUA should adhere to its statutory directive to prevent credit unions from being undercapitalized due to unrestrained asset growth and should act to restrict asset growth of undercapitalized credit unions in a manner that is consistent with restoring a credit union to being adequately capitalized in a timely and permanent manner. The proposal by the NCUA is directly contrary to Congress' purpose in adopting the asset growth limitations of the PCA and appears to be an attempt to evade the statutory restrictions on the NCUA. The NCUA should not adopt the proposal.

Sincerely,

Keith Leggett