Cooperative Credit Union Association
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Creating Cooperative Power

July 26, 2021

Ms. Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

NCUA-2021-0038

Re: Cooperative Credit Union Association Inc.'s Comments on Policy for Setting the Normal Operating Level

BY ELECTRONIC MAIL: http://www.regulations.gov

Dear Ms. Conyers-Ausbrooks:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc. ("Association"), please accept this letter relative to the request by the National Credit Union Administration Board ("NCUA") on its notice and request for comments concerning its Policy for Setting the Normal Operating Level ("Policy") of the National Credit Union Share Insurance Fund ("NCUSIF"). The Association is the state trade association representing approximately 200 state and federally-chartered credit unions located in the states of Delaware, Massachusetts, New Hampshire, and Rhode Island which further serve over 3.6 million consumer members.

I. Overview

The Association conducted a survey of its members on the Policy and the request for comments. Member responses provide the basis for this comment letter. Both the Association and its member credit unions recognize the importance of Section 202 of the Federal Credit Union Act ("Act") which requires the NCUA to establish a target threshold for the Net Operating Level ("NOL") between 1.20 percent and 1.50 percent relative to insured shares. Further, the Association acknowledges that the NCUSIF's equity ratio is 1.26 percent relative to insured shares as of December 31, 2020.

All survey respondents support the efforts of the NCUA to provide notice and request comments on this important industry threshold which impacts all members of the Association.

II. The NCUSIF Target Level Should Return to a 1.30 Percent NOL

The Association notes that the Act expressly authorizes the NCUA to charge a NCUSIF premium when the "premium charge does not exceed amount necessary to restore the equity ratio to 1.3 percent."[1] Accordingly, the equity ratio of the NCUSIF can only generally be increased above 1.30 percent through earnings retention of its interest income absent extraordinary events such as the closure of the Stabilization Fund.

[1] 12 U.S.C. § 1782(c)(2)(B).

The 1.30 percent NOL has been the threshold for most of the NCUSIF's existence. The Association believes that this action is logical given the limitations on the NCUA's ability to charge premiums that would bring the NCUSIF's equity ratio above 1.30 percent. The only exception to the 1.30 percent NOL occurred during the past few years, following an influx of monies to the NCUSIF stemming from the closure of the Stabilization Fund in 2017.

At that time, the NCUA's actions allowed the NCUSIF to retain funds from the Stabilization Fund that otherwise likely would have been distributed to FICUs as a NCUSIF dividend. Since then, the NCUSIF's equity ratio has decreased primarily because of growth in insured shares.[2] The Association does not believe that extraordinary events similar to the Stabilization Fund closure are reasonably probable in the foreseeable future.

Furthermore, the NCUSIF's interest income has been increasingly utilized by the NCUA in recent years to fund its own operations through the Overhead Transfer Rate ("OTR"),[3] which is currently set at 62.3 percent for 2021, increased from 61.3 percent in 2020.[4] As recently as 2008, the OTR was as low as 52.[5] A high OTR hinders the NCUSIF's ability to build retained earnings to increase its equity ratio. Considering that Section 202(c)(2)(B) limits the NCUA's ability to charge premiums to the "amount necessary to restore the equity ratio to 1.3 percent," should the NCUA decide to keep the NCUSIF's NOL above 1.30 percent, then it would be essential for the NCUA also to reduce the OTR to allow the accumulation of retained earnings.

The Association also reminds NCUA that a transparent OTR and reduction in the increasingly high level of the OTR is a top priority of its state chartered FICU members and has been the subject of multiple comment letters from the Association to NCUA.[6]
Savings sufficient to allow the NCUSIF to increase its earnings retention could be achieved by reducing the NCUA's budget or by revising the federal credit union operating fee methodology to be more equitable in relation to state-chartered FICUs.[7] The Association further suggests that if the NCUA is required to adopt a NCUSIF Restoration Plan, then the NCUA should reduce the

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[2] The Association does not address the issue of whether it would have been more equitable in September 2017 to provide a dividend with excess Stabilization Fund monies to federally-insured credit unions ("FICUs"). Such action would have immediately increased all FICUs' net worth ratios and allowed them to invest such costless funds for years to help further build their retained earnings which also protect the NCUSIF. The Association also acknowledges the need to strike the balance between such a dividend and the resulting high likelihood of a future NCUSIF premium.

[3] See, for example, Overhead Transfer Rate Methodology, 85 Fed. Reg. 84,376 (Dec. 28, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-12-28/pdf/2020-28487.pdf; Letter of Michael J. McKenna, General Counsel, NCUA, to Lucy Ito, President & CEO, NASCUS, "Legal Analysis of Overhead Transfer Rate," OGC Letter No. 15-0818 (Aug. 2015), *available at* https://www.ncua.gov/regulation-supervision/legal-opinions/2015/legal-analysis-overhead-transfer-rate.

[4] Memo of Myra M. Toeppe, Director, Office of Examination and Insurance, NCUA, to the NCUA Board of Directors, "2021 Overhead Transfer Rate (OTR) Summary," (Dec. 11, 2020), *available at* https://www.ncua.gov/files/publications/budget/overhead-transfer-rate-summary-2021.pdf.

[5] Overhead Transfer Rate Methodology, 82 Fed. Reg. 55,644, 55,651 (Nov. 22, 2017), *available at* https://www.govinfo.gov/content/pkg/FR-2017-11-22/pdf/2017-25222.pdf.

[6] October 20, 2020 Association comment letters on proposed rules on fees paid by federal credit unions, the overhead transfer rate, and operating fee schedule methodologies.

[7] Budget reduction measures include implementing a hiring freeze and further streamlining regulatory functions including those with state regulatory agencies.

OTR as part of any Restoration Plan. Such steps are consistent with NCUA's requirements of a FICU subject to a Net Worth Restoration Plan to decrease operational expenses and exit non-core lines of business to help the FICU accumulate retained earnings.

The Association strongly urges the NCUA to return the NCUSIF's NOL to 1.30 percent. The NCUA first established a NOL for the NCUSIF in October 1999 at the 1.30 percent level. This threshold remained constant until the NCUA set the currently applicable 1.39 percent NOL in September 2017. This change took place when the NCUA closed the Temporary Corporate Credit Union Stabilization Fund ("Stabilization Fund").[8]

III. NCUA's Questions and Member Responses

The remainder of this comment letter will address the NCUA's proposed questions in the order of presentation.

1. ***Should a moderate recession be the basis for evaluating the Insurance Fund performance during an economic downturn, or should the NCUA change the policy to consider a severe recession?***

Association members believe that a moderate recession is an appropriate basis for evaluating the NCUSIF's performance during an economic downturn with the ability to remain at 1.20 percent of shares for an 18-month time horizon. It should be noted that the NCUA's NOL policy in force from 2007[9] until 2017 was a maximum two-year time horizon. This action established a safe and sound NOL for the NCUSIF, without excessive procyclicality, as demonstrated by its performance during the Great Recession. Accordingly, the Association suggests that an 18-month horizon would be the most appropriate time horizon considering that the actual length of U.S. recessions since the Great Depression have never exceeded 18 months.

Notably, the NCUSIF performed much better during the Great Recession and its aftermath than the Federal Deposit Insurance Corporation's ("FDIC") Deposit Insurance Fund, which was forced to operate at a negative equity ratio in 2011 through 2013 in order to limit excessively procyclical premiums on FDIC-insured banks. Although the NCUSIF did levy premiums on FICUs during the Great Recession, which was the most severe recession since the Great Depression, FICU capital levels remained strong, and the NCUSIF's equity ratio remained above 1.20 percent at the end of each financial quarter even while the FDIC's Deposit Insurance Fund had a negative equity ratio.

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[8] Closing the Temporary Corporate Credit Union Stabilization Fund and Setting the NCUSIF Normal Operating Level, 82 Fed. Reg. 46,298 (Oct. 4, 2017), *available at* https://www.govinfo.gov/content/pkg/FR-2017-10-04/pdf/2017-21305.pdf; Report of James W. Hagen, Inspector General, NCUA, to Mark A. Treichel, Executive Director, NCUA, "OIG Evaluation of the Underlying Rational for the NCUA Board's Closure of the Stabilization Fund and Setting the Normal Operating Level to 1.39 Percent" (Feb. 15, 2018), *available at* https://www.ncua.gov/files/publications/oig-evaluation-stabilization-fund-closure-setting-normal-operating-level.pdf.

[9] NCUA Board Action Memorandum (Dec. 3, 2007).

It is well documented that no U.S. recession has lasted more than one year and six months[10] since the Great Depression in the 1930s which lasted three years and seven months.[11] The recent COVID-19 Recession lasted only two months.[12] In addition, as the NCUA's notice notes, the Federal Reserve Board of Governors is no longer issuing the five-year economic forecasts that NCUA previously relied upon in making these calculations.

The Association suggests that a moderate recession is the appropriate basis for evaluating the NCUSIF's performance during an economic downturn with the ability to remain at 1.20 percent of shares for a maximum 18-month horizon.[13] Furthermore, although the two-year horizon performed well before, during and after the Great Recession, the Association suggests that an 18-month horizon is the most appropriate lookout period based on the historical lengths of U.S. recessions.

2. ***What data source(s) should the NCUA use for determining the characteristics of a potential moderate or severe recession—the Federal Reserve scenario, an independent source, or the NCUA's judgment?***

Association members suggest that using the Federal Reserve Board of Governors' data ("Federal Reserve") is an appropriate source for data to be used in the NCUSIF's NOL stress testing scenarios. The Federal Reserve, similar to most central banks around the world, is an authoritative source as it has traditionally performed the federal government's econometric forecasting function. Such forecasting is related to the Federal Reserve's monetary policy functions including setting interest rates.

Other federal agencies, such as the FDIC, also rely on Federal Reserve forecasts. The Association raises a concern if the NCUA uses its own discretion with respect to econometric forecasting and questions whether inconsistencies across financial institution regulators or qualitatively sub-optimal analyses would result. In the rare situation where Federal Reserve data is not available, then the Association suggests that commercially available econometric forecasts could be used to fill any gaps.

3. ***Should the NCUA continue modeling the performance of the Insurance Fund over a five-year period or a longer or shorter period?***

The Association recommends that a two (2) to three (3) year forecast period. This recommendation is consistent with NCUA's previous Policy and has been deemed appropriate and successful. Furthermore, it reflects the time horizon experienced as no U.S. recessions have exceeded 18-months since the Great Depression. Association members strongly encourage

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[10] December 2007 to June 2009.
[11] National Bureau of Economic Research, "US Business Cycle Expansions and Contractions;" https://www.nber.org/research/data/us-business-cycle-expansions-and-contractions (last visited July 22, 2021).
[12] *Id.*
[13] One survey respondent stated that NCUA should only consider an evaluation tool that has proven historical impact.

consideration of a period that captures the economy entering a down-turn and then improving and accelerating out of the recession into a growing, vibrant economy.

4. ***How should the NCUA utilize the modeled potential decline in value of the Insurance Fund's claims on the corporate credit union asset management estates going forward until the estates are fully resolved?***

The NCUSIF's claims on the corporate credit union asset management estates should not be considered a material factor going forward given the limited tenor of these claims and the fact that these positions are being wound down. Rather than forecast the potential results of an increasingly non-material factor, which could result in paper gains or losses that may be largely speculative, the Association suggests that the NCUA should simply factor in the final result of these positions at the time these positions are closed, and a gain is realized, or a loss is incurred.[14]

5. ***Should the NCUA continue to incorporate in the Normal Operating Level analysis the projected equity ratio decline through the end of the following year without an economic downturn?***

Yes. Association members generally believe that incorporating the projected equity ratio decline through the end of the following year without an economic downturn is a reasonable consideration for the NOL analysis. This is especially true given the long-term trend of aggregate FICU shares increasing essentially every year since the establishment of the NCUSIF in 1971.[15]

6. ***Should this period be longer or shorter, or not factored into the analysis at all?***

At present, the Association suggests that the current period of the end of the following year is a reasonable approach given the limitations on econometric forecasting assumptions. It should be noted that this lookout period could be longer or shorter depending on what time of year the NCUA performs its NOL analysis. A fixed 12-month lookout-period would be more standardized, especially if the NCUA were to consider NOL adjustments at the beginning of a calendar year.

7. ***Given forecasting uncertainties and timing challenges, would it be reasonable for the NCUA to change the requirement to request public comment only if the Normal Operating Level were to change by a larger amount than just one basis point?***

No. The Association does not believe that public comment should only be required if the NOL were to be increased by more than one basis point. The NCUSIF had approximately $19.9 billion

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[14] One survey respondent reminds NCUA to utilize the lessons learned when it conserved corporate credit unions based on false assumptions. The value of assets in the financial system rise and fall and generally do not stay in the same direction forever.
[15] *See generally* CUNA, *Monthly Credit Union Estimates* (May 2021) (including U.S. credit union data since the early 1980s), *available at* https://www.cuna.org/research/.

dollars in total assets as of May 2021 and continues to grow. Accordingly, even a one basis point increase in the NOL is a policy decision involving millions of dollars that affects all FICUs.

The Association strongly urges the NCUA to continue to issue notices and requests for comment regarding changes to the NOL so that its policymaking on the NOL continues to consider the viewpoints of all relevant stakeholders.

8. ***Should the Normal Operating Level be re-evaluated in the midst of an economic downturn or should it be left unchanged until the onset of an economic recovery?***

The NCUSIF's NOL played a limited role during the Great Recession because it is a target ratio, whereas the equity ratio reflects its current economic position. The Association also notes that it is the ratio that the Act uses to determine whether an NCUSIF premium may or must be levied on FICUs.

The NCUA did not adjust the NOL during the Great Recession and only made changes to the NOL eight years after the Great Recession ended. The Association believes that reducing the NOL during an economic downturn could be a useful tool to help reduce the procyclicality of NCUSIF premiums on FICUs. This action would help FICUs preserve their retained earnings, which also protects the NCUSIF. Reducing the NOL from 1.30 percent to, for example, 1.25 percent or 1.20 percent, in the event that an NCUSIF premium is required could be a reasonable methodology to reduce the economic burden and the depletion of FICUs' retained earnings associated with NCUSIF premiums. At a minimum, such action could help spread out these costs on FICUs over time similar to FDIC action taken in a much more extreme form during the Great Recession.

Of related interest are other deposit insurance programs for credit unions, such as the United Kingdom's Financial Services Compensation Scheme ("UK") that insures bank deposits and credit union shares in Great Britain and Northern Ireland. The UK has essentially no pre-paid insurance fund and is a pay-as-you-go system with premiums spread out over time in order to reduce procyclical costs on insured banks and credit unions that would otherwise further reduce their regulatory capital during a period of economic stress.[16] This deposit and share insurance system also performed well during the Great Recession. Although the Act does not permit the NCUA to structure the NCUSIF in the fashion adopted by UK policymakers, the Association suggests that the UK example strongly illustrates the benefits of reducing procyclical insurance premiums on credit unions during an economic downturn. Retained earnings remaining on FICUs' balance sheets also protect the NCUSIF.

9. ***Should the Normal Operative Level be re-evaluated on qualitative factors based on the COVID-19 pandemic?***

The COVID-19 pandemic is marked as an unpredictable, intervening event with significant implications and consequences for credit unions and others. Yet, it remains an event that is

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[16] *See* Financial Conduct Authority of the United Kingdom, "Deposit and savings protection;" https://www.fca.org.uk/consumers/deposit-savings-protection (last visited July 22, 2021).

unlikely to be repeated with such force in the financial arena in the foreseeable future. Therefore, the Association suggests that the NOL should not be reevaluated based on COVID-19 pandemic factors per se, other than perhaps to observe that the COVID-19-related recession only lasted two months and was likely the shortest U.S. recession on record. The Association does, however, support an NCUA Policy that is based on the historical record that all U.S. recessions would last only a few months as has generally been the case since the Great Depression.

10. ***Is there any other information that the NCUA Board should consider when setting the NOL?***

The Association strongly urges the NCUA to return the NCUSIF's NOL to 1.30 percent. Association members also requested that the NCUA consider any premium impact on FICUs during an already difficult time.

The Association seeks to make clear today that it does not support a premium assessment in the near future. The NCUSIF is healthy at 1.26% and a premium is not needed or required at this point. Credit unions are faced with a challenging environment from the pandemic and a premium will add to these challenges, as credit unions continue to assist their members and communities. In addition, it's important to note the equity ratio is historically strong at 1.26% despite the enormous fiscal stimulus that resulted in a 20% increase in insured shares during 2020. As a result, it is premature to assess a premium as there is the reasonable potential the increased deposits may start to flow out from credit unions, thereby increasing the equity ratio. Simply put, the NCUSIF is healthy and economic conditions do not warrant a premium at this time.

IV. Conclusion

The Association appreciates the opportunity to comment on NCUA's notice and request for comments concerning its Policy and respectfully offers the views of members as presented. If you have any questions about the recommendations set forth in this comment letter or require further information, then please do not hesitate to contact the Association at govaff-reg@ccua.org.

Sincerely,

Ronald McLean
President/CEO
Cooperative Credit Union Association, Inc.

RM/MAC/KB