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August 30, 2005

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428.

Re: National Credit Union Administration; Regulatory Flexibility Program; 12 CFR Part 742; 70 Federal Register 43796, July 29, 2005

Dear Ms. Rupp:

The National Credit Union Administration (“NCUA”) is proposing to lower the capital requirement for credit unions to automatically qualify for its Regulatory Flexibility (“RegFlex”) program. The American Bankers Association (“ABA”) opposes reducing the capital requirement for federal credit unions to achieve automatic RegFlex designation; but is supportive of a capital duration requirement for RegFlex eligibility. Lowering the capital standard under which a credit union qualifies automatically for RegFlex eligibility raises the potential risk exposure to the National Credit Union Share Insurance Fund (“NCUSIF”). Additionally, ABA recommends that the agency revisit its position that past actions taken under that authority are “grandfathered,” i.e., they will not be disturbed or undone.

The American Bankers Association, on behalf of the more than two million men and women who work in the nation’s banks, 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.

Background

In 2002, the NCUA Board established a Regulatory Flexibility Program that exempts qualifying credit unions in whole or in part from a series of regulatory restrictions, and grants them additional powers. For example, credit unions that received RegFlex designation were granted relief from regulatory limits on fixed assets, charitable contributions, and nonmember deposits.¹

To qualify automatically under the existing RegFlex Program, a credit union must meet two criteria. First, it must have a composite CAMEL rating of “1” or “2” for

¹ 12 C.F.R. 742

two consecutive examination cycles. Second, it also must achieve a net worth ratio of 9 percent (200 basis points above the net worth ratio to be classified “well capitalized”) for a single Call Reporting period, unless it is subject to a risk-based net worth (“RBNW”) requirement.² In that case, the credit union’s net worth must surpass its RBNW requirement by 200 basis points. As of December 31, 2004, 3457 federal credit unions or 62.04 percent of all federal credit unions automatically qualified for RegFlex. According to the NCUA, only one federal credit union had its RegFlex authority revoked during 2004.

Proposal

The proposed rule would align the net worth criterion for RegFlex with the “well capitalized” net worth category under NCUA’s system of prompt corrective action (“PCA”).³ Accordingly, the proposed rule would lower the qualifying minimum net worth classification to “well capitalized,” requiring a minimum net worth of 7 percent. Additionally, NCUA proposes that to automatically qualify for the RegFlex program a credit union has to be well capitalized for six quarters.

The impact of the proposed changes would increase the number of credit unions that would be automatically eligible for the RegFlex program. If the proposed criteria were applied in 2004, 3,919 credit unions or 70.33% of all federal credit unions would have become eligible as of December 2004.

ABA’s Position

Unfortunately, in the proposal the NCUA Board seems to be substituting its own judgment for that of Congress. Congress has stated that a 7 percent net worth requirement is not too high for credit unions, but rather the bare minimum for a credit union to be recognized as well capitalized.⁴

In the face of that clear intent of Congress, attempting to justify the proposed changes to the RegFlex Program automatic eligibility, NCUA Chairman Johnson in a July 14, 2005 press release stated: “If we agree that 7% leverage is an unnecessarily high ratio for “well capitalized” status under a system of risk-based prompt corrective action, then we should not set the bar even higher for RegFlex.”⁵

Moreover, it is clear that the intent of NCUA is to further lower the capital eligibility requirements for credit unions to engage in RegFlex authorities. In its Prompt Corrective Action (“PCA”) Reform package submitted to Congress, NCUA recommends lowering the net worth requirement to 5 percent for a credit union to be well capitalized. Given the proposed modifications in the RegFlex eligibility standards, this would mean that the effective standard to automatically engage in RegFlex authorities for credit unions would be 5 percent.⁶

² 12 C.F.R. 742.1

³ 12 U.S.C. 1790d(c)(1)(A)

⁴ Senate Report 105-193, May 21, 1998, pp.13.

⁵ http://www.ncua.gov/news/press_releases/2005/NR05-0714-2.htm

⁶ <http://www.ncua.gov/ReportsAndPlans/special/PCAProposal.pdf>

Experience indicates that credit unions that consistently maintain a high net worth ratio and a high CAMEL rating pose less risk to the NCUSIF. Lowering the net worth eligibility criteria would only increase the risk exposure to the NCUSIF.

Furthermore, NCUA's RegFlex program has only been in effect since 2002 and has not gone through a full business cycle. With this limited experience, it would be premature to alter the eligibility criteria. NCUA should monitor and evaluate the performance of current RegFlex credit unions over the course of a full business cycle before proposing changes to lower the eligibility criteria.

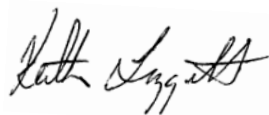
ABA believes that federal credit unions should meet more than the bare minimum standard for being well capitalized to participate in the expanded authorities under NCUA's RegFlex program. To be eligible to participate in such a program, a federal credit union should demonstrate superior performance with regard to its capital management. Therefore, the NCUA Board should retain the current standard that credit unions have to be at least 200 basis points above the minimum standard for being well capitalized to exercise RegFlex authorities.

However, ABA is supportive of imposing a capital duration requirement for RegFlex eligibility. Currently, eligibility is based upon a single momentary snapshot in time. ABA agrees with the Board that such snapshot is too fleeting to be evidence of superior performance.

Finally, while not part of the proposed rule, ABA believes that the agency should revisit its position that past actions taken under that authority are "grandfathered," i.e., they will not be disturbed or undone. If a credit union loses its RegFlex designation, it should be required to restore its designation within a meaningful period of time, such as 4 to 8 quarters, to continue to exercise these expanded authorities. Otherwise, the credit union should be required to divest itself of the activity in an orderly fashion.

In conclusion, NCUA should retain the requirement that credit unions meet a capital cushion of 200 basis points in excess of the minimum standard to be well capitalized to automatically qualify for RegFlex authorities. If you have any questions, please contact the undersigned or John Rasmus at 202-663-5333.

Sincerely,

A handwritten signature in black ink, appearing to read "Keith Leggett". The signature is written in a cursive style with a large initial "K".

Keith Leggett
Senior Economist