NEW YORK creditunion ASSOCIATION

September 12, 2022

Hon. Todd M. Harper, Chairman
Hon. Kyle S. Hauptman, Vice Chairman
Hon. Rodney E. Hood, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314–3428

RE: Interest Rate Risk Evaluation and the continued use of the Net Economic Value Test

Dear Chairman Harper,

On behalf of the New York Credit Union Association, which has represented both state and federally chartered credit unions for more than 100 years, I am writing this letter to underscore the urgent need for NCUA to continue to modify its use of a Net Economic Value Test to evaluate credit union exposure to the type of sudden interest rate increases we are now experiencing. NCUA should also use this opportunity to holistically review the interest rate framework it has implemented since 2012. While the recent steps taken by NCUA in response to industry concerns are welcomed and needed steps in the right direction, more needs to be done.

In recent months, credit unions have reached out to the Association complaining that they have been "clobbered" in their most recent examinations, which have been the first to occur in this high-interest rate inflationary environment. Credit unions with unchanged portfolios that have consistently had solid examinations have suddenly found themselves subject to DORs for allegedly posing an "extreme risk" to the share insurance fund.

The roots of this problem started in 2012 when NCUA implemented an enhanced framework for evaluating interest rate risk with a particular emphasis on evaluating credit unions with $50M or more in assets. In 2016, NCUA augmented this framework by expanding the use of the NEV Test as a scoping mechanism for determining which institutions are at greatest risk. Under this new approach, non-maturity deposits were effectively given a negative risk weighting of 1% and credit unions categorized as posing an extreme risk under this formula had to be given a DOR with examiners unable to consider the overall soundness of the credit union's approach to interest rate risk. With NCUA's recent decision to eliminate the extreme risk category and give examiners discretion in determining whether a DOR is appropriate, it has addressed the industry's most immediate concerns.

But even with these changes, there are additional steps that NCUA should take. Most importantly, it should consider whether its existing use of NEV is appropriate for the credit union industry. Approximately 70% of credit union assets are derived from non-interest-bearing member deposits. Crucially, since these accounts cannot be bought or sold on the open market — the way bonds can be for example — it is impossible to accurately assess the sensitivity of these deposits to changes in interest rates. The existing 1% premium imposed on credit unions by NCUA is, at best, a well-intentioned ultimately counterproductive one-size-fits-all valuation which has been proven to mis-categorize the financial strength of well-functioning credit unions.

Against this backdrop, NCUA should eliminate the use of NEV for categorization purposes. If it is unwilling to take this step, it should give credit unions the opportunity to demonstrate how their own existing approach for evaluating interest rate sensitivity either under NEV or within an entirely different ratio is sufficient.

In 2012, when NCUA started implementing a more enhanced framework for evaluating IRR, credit unions with $50M or more in assets were considered large institutions for regulatory purposes. More than a decade later, the industry has radically changed and the trend towards larger credit unions is likely to continue. Today, for example, only credit unions with $500M or more in assets must comply with NCUA's more advanced net-worth requirements. When the NCUA implemented enhanced IRR regulations in 2012, it assured the industry that:

"*…our standard for interest rate risk policies is not one-size-fits-all. We realize that exposed credit unions have different risk profiles. So while the rule provides guidelines for policies, we are also providing flexibility for credit union managers and board members to develop their own policy – and we are giving affected credit unions several months to comply*."

Just as NCUA recognized in 2012 that there are asset levels below which credit unions are best served with maximum flexibility in managing interest rate risk, the NCUA should update the existing enhanced regulatory thresholds so that they only apply to credit unions with $500M or more in assets.

We greatly appreciate the NCUA's willingness to engage with the industry and quickly respond to its concerns. As NCUA further refines its approach to IRR in the coming weeks, the steps we have outlined will enhance the industry's safety and soundness while not restricting the flexibility of well-managed credit unions.

Sincerely,

William Mellin

President/CEO