

December 2, 1999

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

Dear Ms. Baker:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, in response to NCUA's request for comment on its proposed strategic plan for the years 2000-2005.

NAFCU would like to take this opportunity to thank NCUA for soliciting input from credit unions and trade associations prior to the issuance of their proposed strategic plan. NAFCU hopes that the agency is as responsive to our critique of this draft as staff was to our initial suggestions. We look forward to working with the agency toward the development of a plan that allows credit unions to continue to operate in a safe and sound manner in the next century.

NAFCU believes that NCUA has developed a strong plan with generally achievable goals. Our support for the plan itself, however, is somewhat tempered by the existence of a number of strategies and performance measures that are inappropriate or costly. One of our greatest concerns is the agency's apparent plan to provide examiners with excessive power over areas of operation or policy-making that can only be done by management or the board of directors. This objection is discussed at length in the comments below. Also, NAFCU is concerned with the numerous instances where NCUA has indicated that additional staff may be required to fulfill the various outcome goals. NAFCU is concerned with the budget implications associated with such a vast hiring spree. For this reason, NAFCU urges the agency to find ways to achieve their goals through the reallocation or use of existing resources.

While NAFCU appreciates the forward looking and thinking exhibited by the objectives advanced by NCUA, there is one objective more prominent by its absence that should be included in the plan. NCUA's objectives should include efforts to take advantage of technology to make the agency more efficient and its operating more cost-

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effective while reducing the financial burden imposed on credit unions to support a continually growing bureaucracy.

Strategic Goal 1: Promote a system of financially sound, well managed federally insured credit unions able to withstand economic volatility

Outcome Goal 1.1 – Ensure that federally insured credit unions are financially healthy

Although this is clearly an appropriate strategic and outcome goal for NCUA to have in light of the agency's role as insurer of credit unions, NAFCU questions the inclusion of several of the strategies that NCUA proposes implementing to achieve this outcome goal. We also question the appropriateness of some performance measures associated with this outcome goal.

The first strategy articulated under Outcome Goal #1.1 is to “develop training and a management philosophy which empowers *examiners* to choose the appropriate examination scope.” (emphasis added). NAFCU believes that this strategy places far too much power in the hands of individual examiners. It is unclear as to what relevance such power even has with respect to the promotion of a system of financially sound credit unions. Examiners should not be given so much power by NCUA that they act as a surrogate manager for the credit union, substituting their own vision of what is good for the credit union for that of the credit union's own management or board of directors.

Attention to risk is a prominent thread throughout the strategies designed to accomplish Outcome Goal #1.1. NAFCU cautions the agency against placing so much emphasis on risk that the ability of credit unions to effectively manage such risk is lost on the examiner. Heightened attention to certain areas of credit unions' portfolios or more vigorous investigations into credit unions that NCUA has deemed to be complex, ignores the basic fact that risk can, and often is, well managed by all types of credit unions. NAFCU believes that if credit unions are doing their job of protecting members, then examiners do not need to scrutinize each part of the credit union's portfolio as though it were somehow dissected from the rest of the credit union's operations.

In addition to the strategies discussed above, NAFCU believes that NCUA should take another look at the performance measures associated with Outcome Goal #1.1. NCUA limits the performance measures to ratios designed to indicate the health of the financial institution. Again, NAFCU would propose that the agency take a broad look at credit unions' operations to indicate health rather than place a blind reliance on mere numbers. Financial health is not simply a function of how well the credit union is currently performing. Health of credit unions, individually and collectively, depends on

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the ability of credit unions to remain competitive. To be competitive, however, credit unions need a degree of regulatory and supervisory flexibility that this outcome goal seems to ignore.

Outcome Goal 1.2 – Ensure that credit union management is aware of and prepared to meet potential financial changes

Assuming that the strategies associated with Outcome Goal #1.1 placed too much power in the hands of the examiner, Outcome Goal #1.2 multiplies that error tenfold. In order to accomplish this outcome goal, NCUA would have examiners act not only as a surrogate for credit union management, but also as their financial advisors – dictating what strategies will prove to be effective in the future and those that will not. NCUA takes this idea so far as to say that credit unions' CAMEL ratings will be affected by examiners' evaluations of the "adequacy" of management's assessment of risk. NAFCU urges NCUA to rethink the strategies associated with this outcome goal in their entirety, as the role of examiners is not to set policy or make decisions for credit unions. It is clearly beyond the scope of NCUA's authority to craft a strategic plan that places the ideals of the examiner above those of management.

In light of the fact that NAFCU has taken issue with the strategies associated with this outcome goal, we also take issue with the performance measures associated with such strategies. Determining the adequacy of credit unions' business plans, strategic plans, and ALM policies, procedures, measures and analysis all but gives examiners the ability to usurp management. These strategies and performance measures portray NCUA as being not unlike an overprotective parent– substituting its own judgment despite the credit union's maturity, experience and ability to know what is best.

Outcome Goal 1.3 – Maintain the healthy performance of the insurance fund

In connection with this outcome goal, NAFCU would remind NCUA that credit unions are already under the belief that prompt corrective action (PCA) imposes too much of a burden on their operations without the agency attempting to add to that burden by implementing examination and supervision "programs" designed to target precisely those activities that will be covered under PCA. NCUA is also advocating an emphasis on the use of Asset Liability Management (ALM) models. This vague statement leaves NAFCU wondering if NCUA will be promoting some models over others, or will go so far as to take a position on the use of only certain "certified" models.

Also, in an effort to preserve the healthy performance of the insurance fund, NCUA states that it will "[s]trive to preserve the structural integrity of credit unions by

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exploring all other options before merger.” NAFCU is unclear on how this strategy is related to the maintenance of a healthy insurance fund, but is even more disturbed by the agency’s apparent disregard for the business decision of the two credit unions that desire the merger. This strategy is especially hard to understand in light of the fact that mergers are often used by credit unions that believe they will have to terminate operations absent the influx of new capital and members.

In connection with the performance measures to support this outcome goal, NAFCU questions the inclusion of “interest rate sensitivity in stress scenarios.” Because NCUA has admitted that this information is not currently available, NAFCU is concerned that this will be one more item that the credit union will need to prepare for an examiner’s review. In light of the potentially burdensome nature of this requirement, NAFCU would urge NCUA to reevaluate the inclusion of this performance measure.

Strategic Goal 2: Ensure that credit unions are prepared to safely integrate financial services and emerging technology in order to meet the changing needs of their members

Outcome Goal 2.1 – Ensure that credit unions have access to information and training about emerging financial service technology and use this information to integrate innovative technology planning, contracting, deployment, and support within the credit union framework

NAFCU believes that it is important that NCUA educate its examiners with respect to technology issues. We would, however, urge caution in this area in that an overzealous examiner has the potential to thwart a credit union’s innovations before the credit union can even get started.

Outcome Goal 2.2 – Ensure that credit unions understand emerging security threats and are prepared to deal with them

NAFCU believes that as member confidence grows in credit unions’ ability to conduct financial transactions on-line, so will the number of members that choose that method to obtain services. NAFCU, however, would caution the agency against developing guidelines or assessing the adequacy of credit unions’ security measures without a full understanding on the subject. The performance measures also indicate that examiners will be looking into the adequacy of credit union security policies and practices. NAFCU is concerned that examiners will start to test credit unions for compliance with standards that they have not been adequately prepared to investigate

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Outcome Goal 2.3 – Promote public trust in credit union deployment of emerging technology

NAFCU takes issues with some of the strategies designed to accomplish this outcome goal. First, NAFCU objects to NCUA's desire to seek permanent supervisory authority over credit union information technology service providers. Although such authority was granted in light of the potentially devastating affect that Y2K could have had on credit unions, NAFCU sees no reason why this authority should be perpetuated. NCUA's purported area of expertise is in the regulation and supervision of credit unions – not business enterprises that provide support services to credit unions.

NAFCU also questions the timeliness of any effort by the agency to develop a comprehensive and detailed examination for security on the Internet. First, technology moves so rapidly that those practices that are thought to be adequate today may become obsolete tomorrow. Because use of on-line financial services simply will not exist if members do not trust their credit union, NAFCU would argue that this area is effectively self-regulating and would require minimal intervention by NCUA.

Strategic Goal 3: Create a regulatory environment that will facilitate credit union innovation to meet member financial service expectations

Before reaching the merits of the outcome goals associated with this strategy, NAFCU would like to point out a particularly offensive paragraph included in the background discussion of this strategy. NCUA states:

An excellent opportunity for credit union growth resides with the booming minority and immigrant population These growing minority populations, have their own cultural views of financial services and their own expectations and requirements for service delivery. For some, the use of technology may be a future vision, but not a practical one today, due to lower income levels and language barriers.

NAFCU is adamantly opposed to any deliberate effort on the part of NCUA to divide credit union fields of membership along cultural, ethnic or racial lines. Is NCUA promoting a policy for credit unions to target their more basic services toward those members (or potential members) that have foreign-sounding last names or have immigrated to this country only recently? NAFCU is sure that NCUA would agree that such a division is offensive if not outright discriminatory. Credit unions should make an

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effort to make their entire range of services available to *all* of their members. Although credit unions have traditionally been the vehicle through which people of modest means have been provided financial services, this does not mean that credit union members are deserving of only modest services (especially if the degree of sophistication of the member is based on not much more than his/her ethnicity).

Outcome Goal 3.1 – Assist credit unions in understanding the impact of changing membership and in positioning themselves to address changing member expectations

Although this outcome goal was released well before President Clinton signed the Financial Modernization Bill into law, this outcome goal embraces the challenges that this historic law will provide for credit unions in the future. Competition for the provision of financial services will increase exponentially in coming years, and credit unions need NCUA to provide them with the flexibility and ingenuity to remain a viable alternative for consumers.

NAFCU does not, however, support the performance measures associated with this outcome goal. It is extremely unclear to us how the number of new car and real estate loans can enlighten the agency on such matters as changing membership bases or differing expectations. The agency is falling into a trap where they are relying on those products that they are familiar with to determine the desires of consumers in the future. This is clearly unreasonable in light of the purpose of this outcome goal.

Outcome Goal 3.2 – Empower credit unions and their members to succeed. Ensure that neither examination focus nor regulations become an unreasonable stumbling block.

NAFCU encourages NCUA to take an active role in examining existing regulations for areas of improvement. One suggested strategy under this outcome goal is the use of pilot programs. In order for such pilot programs to work, however, NAFCU urges the agency to take a more aggressive role in the approving of pilot participants. As has been the problem in the past, entrepreneurial credit unions do not want to wait years for approval into the agency's pilot programs.

Outcome Goal 3.3 – Facilitate credit unions partnering with each other and other financial service providers in order to meet member service expectations.

NAFCU supports an outcome goal that would encourage credit unions to work together in a cooperative spirit. NAFCU also expects that the use of CUSOs will become more prevalent in the years to come, and encourages NCUA to ensure that the CUSO regulation remains flexible and workable.

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Strategic Goal 4: Enable credit unions to leverage their unique place in the American financial services sector to make service available to Americans who are not currently being served

Outcome Goal 4.1 – Increase the number of credit union members

NAFCU wholly supports efforts by NCUA to educate the public with respect to the positive attributes of credit unions. As a trade association representing the interests of federally-chartered credit unions, we would offer our assistance to the agency in any way to help bring about a greater interest on behalf of members and select groups to join existing credit unions. Similarly, for those groups that have adequate resources and commitment, NAFCU would help to encourage the formation of a new credit union, and would work to partner the fledging credit union with an existing credit union to ensure the success of the new institution. Along these lines, NAFCU would also urge the agency to review its select employee group addition process in order to determine whether there are any ways to improve the speed and efficiency of the process.

Outcome Goal 4.2 – Increase credit union service to underserved areas

Although NAFCU respects the agency's commitment to serving the underserved, there is some question as to the necessity of this outcome goal in light of the previous one. Should we assume that Outcome Goal 4.1 speaks only to increasing the number of middle- or upper-class credit union members? Clearly not. Special emphasis on serving the underserved somehow implies that credit unions do not, as a matter of course, reach out to all of their potential members. NAFCU hopes that the agency did not mean to imply this, and would hope that clarification of this goal is apparent in the final version of this strategic plan.

As for the addition of underserved communities into the fields of membership of existing credit unions, NAFCU supports the agency's intention to work with existing community organizations. Credit unions that are associated with an organization that the community trusts and is familiar with will have an increased chance of successfully reaching out to members of that community.

Strategic Goal 5: Enhance NCUA's organizational ability to serve as a proactive partner with the credit union community in addressing the challenges of the 21st century

Outcome Goal 5.1 – Ensure that NCUA has the ability to identify issues and trends and implement timely solutions before issues become critical.

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NAFCU supports efforts by NCUA to ensure that its regulations adequately reflect changes in external factors. NAFCU's only hesitation in connection with this outcome goal is that NCUA may become too zealous in its search for potential problems and would defeat the purpose of the larger strategic goal by making credit unions less competitive in the coming years through the implementation of overly burdensome prophylactic regulations.

Outcome Goal 5.2 – Ensure that NCUA's examination and supervision program incorporates a balanced view of safety and soundness and empowers the examiner to focus on risk evaluation and problem resolution.

Reiterating a previous concern, NAFCU urges NCUA to not put examiners in a position to usurp the role of management. Although the strategies associated with this outcome goal would indicate a focus on making the examination process less burdensome, the outcome goal itself would lead one to believe that examiners will be taking a more proactive role in making and enforcing policy. As we have indicated earlier, NAFCU is adamantly opposed to any efforts by NCUA to involve examiners so intimately into credit union affairs.

Outcome Goal 5.3 – Ensure that NCUA has the organization in place to support a renewed emphasis on credit union growth and development.

NAFCU strongly supports any efforts by NCUA to make the select group addition process less burdensome (yet remaining consistent with the law) and to promote groups to establish new charters. We urge the agency to establish uniform procedures for the establishment of such new charters since our experience in this area so far has been widely inconsistent among the regions. NAFCU offers to work with the agency in order to achieve this outcome goal.

Thank you for this opportunity to share NAFCU's views regarding the proposed strategic plan. Should you have any questions or require additional information please call me or Suzanne Garwood, NAFCU's Director of Regulatory Affairs, at (703) 522-4770 or (800) 336-4644 ext. 266.

Sincerely,

Kenneth L. Robinson
President