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STATEMENT OF

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BEFORE THE
HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING ON H.R. 3461, THE FINANICAL INSTITUTIONS EXAMINATION FAIRNESS AND REFORM ACT

WEDNESDAY, FEBRUARY 1, 2012

I. Introduction

Chairman Capito, Ranking Member Maloney, and Members of the Subcommittee, the National Credit Union Administration (NCUA) appreciates the invitation to offer our views on H.R. 3461, the Financial Institutions Examination Fairness and Reform Act.

Introduced by Chairman Capito and Ranking Member Maloney, H.R. 3461 seeks to improve the examination process for depository institutions by, among other things, making available to financial institutions the information used to make examination decisions and codifying certain examination policy guidance. The bill also would create an ombudsman at the Federal Financial Institution Examination Council (FFIEC) to which financial institutions could raise concerns with respect to their examinations. Additionally, H.R. 3461 would establish an appeals process before independent administrative law judges overseen by the FFIEC ombudsman.

In the invitation to testify, the Subcommittee has asked NCUA to comment on the need for reforming the examination appeals process. The invitation also requests NCUA's views on whether H.R. 3461 appropriately and effectively reforms the examination appeals process. Finally, the Subcommittee has inquired about the need to amend the legislation to better achieve the bill's objectives.

In difficult economic times, depository institutions will encounter additional stresses. As a result of these pressures, safety and soundness problems will increase, and financial services regulators, including NCUA, will take prompt action to address the identified issues and mitigate emerging risks. NCUA takes these actions in order to maintain the safety and soundness of credit unions, safeguard the National Credit Union Share Insurance Fund (NCUSIF) from losses, protect consumer deposits, and endeavor to assure that taxpayers not experience a loss.

When regulatory actions increase, complaints against the regulator typically rise. NCUA believes that credit unions should have an effective appeals system that works to resolve legitimate concerns and protect against reprisals. NCUA also works to minimize

complaints by comprehensively training our examiners and encouraging stakeholders to communicate with us before, during, and after an examination.

This written testimony will provide general background about NCUA and NCUA's existing examination process. It will also highlight the strengths of NCUA's current appeals process, which we believe respects credit unions, and brings fairness to our actions and determinations.

Most importantly, this statement will outline how the implementation of H.R. 3461, as introduced, could produce a number of unintended consequences, including increased administrative costs, higher insurance premiums, and less examination flexibility. To pay for these higher costs, credit unions will likely lower interest rates for deposits and increase interest rates for loans. As a result, consumers will ultimately bear the costs of this legislation, and NCUA expects that the time to resolve emerging issues in credit unions will be greatly extended. The increased time to settle issues, however, runs counter to the recent recommendation of the Government Accountability Office (GAO) that NCUA "require early and forceful regulatory action" well before capital deterioration triggers the statutory tripwires of prompt corrective action.

II. About NCUA

NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. NCUA performs this important public function by:

- examining all federal credit unions;
- participating in the supervision of federally insured, state-chartered credit unions in coordination with state regulators whenever possible; and
- insuring federally insured credit union members' accounts.

In its statutory role as the administrator of the NCUSIF,[1] NCUA provides oversight and supervision to 7,179 federally insured credit unions. These federally insured credit unions represent 98 percent of all credit unions and serve 91.4 million credit union members.[2]

III. NCUA's Current Appeals Process

NCUA recognizes that our examination process, like that of every other financial institution regulator, can be improved and enhanced. As such, we are constantly working to refine our examination methods and practices. Moreover, NCUA actively works to minimize complaints about the examination process through comprehensive training for our examiners on proper examination procedures, effective communication, and the need to remain objective and respectful at all times. We also encourage credit unions to communicate with us throughout the examination process. Effective communication between the regulator and the regulated can often resolve problems on the frontlines and avoid the need for pursuing appeals.

In working to protect deposits, keep the credit union system safe and sound, and maintain a strong insurance fund, NCUA must ensure that every federally insured credit union operates in accordance with the law, in the best interest of its members, and that its officers and directors are held to the highest fiduciary standards. The NCUA examiner is at the forefront of these regulatory efforts, making sure every federally insured credit union meets these requirements.

NCUA holds our examiners accountable for their findings, which is why they must conduct thorough reviews. This accountability, however, should not prevent an ongoing dialogue between credit unions and examiners. Consistent with the timelines contained

[1] Congress established the NCUSIF in 1970 as part of the Federal Credit Union Act (P.L. 91-468) and amended the NCUSIF's operations in 1984 (P.L. 98-369). The NCUSIF operates as a revolving fund in the U.S. Treasury under the administration of the NCUA Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state credit unions that request insurance. As of November 30, 2011, the NCUSIF had total assets of $11.7 billion dollars.

[2] NCUA does not oversee approximately 150 state-chartered, privately insured credit unions. The term "credit union" is used throughout this statement to refer to federally insured credit unions.

in H.R. 3461, NCUA also prioritizes the timely delivery of examination reports by examiners so credit union management and boards can take prompt action to address problems. For this reason, credit unions should maintain continuing discussions with their examiners to solve problems before the issuance of examination findings.

When ongoing, two-way communication fails to produce a consensus for resolution, credit unions have other avenues to voice their concerns. Specifically, NCUA has adopted an appeals system to consider and resolve legitimate problems. This system allows credit unions to appeal examination findings through formal and informal channels, including to our Supervisory Review Committee.[3] To prevent unnecessary conflicts and appeals, NCUA examiners do their best to provide regular feedback to credit unions, and NCUA encourages credit union management to engage with our examiners before receiving the final report.

When examination problems arise, NCUA recommends that credit union management first engage directly with their examiners to resolve these issues. Direct communication often resolves issues like implementation timelines and the imposition of new controls. By talking to each other, the parties frequently can come to a meeting of the minds, or, at the very least, a better understanding of the issues involved. This step can be effective when there is disagreement over the facts, conclusions, or tone of the examination report.

Should the discussions with the examiner fail to produce a solution acceptable to the credit union, NCUA advises credit unions to contact the supervisory examiner, who will evaluate the facts and review the examiner's analysis. At this time, each NCUA supervisory examiner oversees about 9 examiners and roughly 93 credit unions.

If consultations with the supervisory examiner do not resolve a problem, a credit union may appeal the issue to the regional office in which it is located (there are five

[3] The Riegle Community Development and Regulatory Improvement Act of 1994 (P.L. 103-325) required each federal banking agency and NCUA to establish an independent, intra-agency appellate process. NCUA created its Supervisory Review Committee in response to the Riegle Act's mandate.

throughout the nation). Credit union management would initiate this appeal by sending a letter to the regional office. The regional director would then weigh the facts involved and reach a decision.

Should the regional director fail to find common ground with a credit union, a credit union may contact NCUA's Supervisory Review Committee as the next step in the appeals process. This independent panel comprised of three senior NCUA professionals, none of whom is involved with the examination process, considers and makes recommendations on a variety of issues. Primarily, though, it handles appeals on examination CAMEL ratings, the adequacy of loan loss reserve provisions, and classifications on loans that are significant to an institution. A credit union may then appeal a decision of the Supervisory Review Committee to the NCUA Board.

A credit union's ability to seek redress is in no way limited to the procedures outlined above. Informal dispute resolution mechanisms include writing to NCUA's Office of General Counsel about legal issues or NCUA's Office of Examination and Insurance about safety and soundness matters. When warranted, credit unions may also contact NCUA's Office of the Inspector General.

Moreover, consistent with a requirement of H.R. 3461, NCUA has already taken steps to ensure that credit unions may appeal without fear. To protect credit unions from examiner reprisals, NCUA has instituted a zero-tolerance retaliation policy. Examiners may not take action against a credit union for using any formal or informal appeal channel. Moreover, every exam report provides information on the appeals process and reference to our non-retaliation policy. NCUA's policy is also available on our public website.

IV. Addressing Examination Problems Promptly

As noted earlier, NCUA works to prevent problems in the examination process and minimize complaints by credit unions. NCUA's supervisory examiners play an important

role in this regard. NCUA deploys these supervisors in the field with our examiner staff to ensure that NCUA has decision-makers in place at credit unions when problems emerge. The ability of our supervisory examiners to get immediately involved in the examination process often resolves issues as they arise and before they approach the level of a major complaint.

Sometimes an examiner's actions may lead to a problem, and the supervisory examiner must step in to resolve the matter. For example, during a routine examination at one troubled credit union, the supervisory examiner attended the exit meeting. During the meeting, the supervisory examiner observed considerable stress and at times hostile comments from the credit union's leadership. Management had concerns about the decision to keep the credit union in troubled status because of a failure to fully resolve all of the problems identified in prior examinations. As the meeting progressed, the discussions became strained. The supervisory examiner also observed a loss of objectivity from the examiner, so the NCUA supervisory examiner stepped in, changed the meeting's tone, and directed the rest of the joint conference. Subsequently, the supervisory examiner counseled the examiner on more appropriate ways to handle the situation.

In another case, the manager of a small credit union complained to the supervisory examiner about the lack of respect demonstrated by the examiner. As a result, the supervisory examiner joined the onsite portion of the examination. The issue arose from the examiner's practice of walking into the manager's office without knocking, and using the photocopier or pulling loan files independently without seeking the manager's assistance. Given the limited space, the credit union had located both the copier and loan file cabinets in the manager's office. The supervisory examiner, upon observing the interaction between the examiner and the manager, counseled the examiner, and instructed him to knock and respectfully request the use of the photocopier and access to the records needed for the examination. The supervisory examiner resolved the issue onsite and before the issues escalated to a formal complaint.

As much as we would like to believe that all credit union officials have the best interest of their credit union and its members at heart, some, unfortunately, do not. It is in these instances that examiners often receive criticism for being too tough. Yet, this is when an NCUA examiner performs at his or her best. The following two examples detail an instance when a difficult examination led to the uncovering of fraud and one case when anger by a credit union to its lowered CAMEL rating was appealed unsuccessfully, only to have the credit union realize the situation was far worse than it had imagined.

In one credit union, the CEO openly displayed hostility toward the team of examiners, causing the examiners to work under duress during most of the fieldwork. The CEO repeatedly challenged the examiners, questioning why they needed certain information, and frequently quoting policy from the NCUA examiner's guide. Although the manager often degraded examiners as lacking sufficient knowledge, the examiners maintained their professionalism throughout the examination. During a review of key employee accounts, the examiners noted a single, unusual deposit in the CEO's personal account. After further investigation, the examiners discovered that the CEO had funneled tens of thousands of dollars from a sweep account for several years.

In some instances, an NCUA examination will identify a problem at a credit union for which management will at first express doubt, but later express appreciation. At a large credit union, for example, examiners observed inappropriate responsiveness to the recent mortgage market crisis. A key problem involved the use of a valuation methodology inconsistent with current economic conditions. During the examination, the credit union's management openly challenged NCUA's conclusions and expressed anger about the downgrade to a troubled CAMEL code.

After an unsuccessful appeal, NCUA examiners performed a new supervisory contact at this credit union. During the contact, the credit union indicated that it had not only adopted NCUA's recommendations, but it also admitted that the conditions about which NCUA examiners had warned were worse than imagined. The credit union's management subsequently took very drastic actions to reverse the financial erosion of

the credit union. In this case, the credit union did not initially agree with the examiner and challenged the exam. Calling the credit union's attention to the problem and requiring management to take action when it did, however, likely saved this credit union from failing.

V. Current Economic Environment and the Regulatory Response

NCUA is aware of and understands the pressures that financial institutions must confront on a daily basis, particularly during difficult economic times. As a result of the recent financial crisis, credit unions have experienced historically high default rates, although these rates have begun to decline since peaking in 2009. Additionally, difficult economic periods can lead to increased fraud at credit unions. Falling home prices, unemployment, and lower investment returns have also affected the bottom lines of credit unions in recent years.

Despite these and other challenges, credit unions have weathered the economic crisis relatively well. The industry's net worth ratio has increased from 9.89 percent in December 2009 to 10.15 percent in September 2010. Over the same time period, the system's return on average assets has jumped from 0.18 percent to 0.66 percent. NCUA continues to closely monitor the industry's performance in order to make adjustments to the agency's examination program aimed at identifying emerging risks and addressing problems on a forward-looking basis.

As noted earlier, credit unions will encounter additional threats to their safety and soundness during periods of economic uncertainty. In response, NCUA must take prompt actions to address the identified problems and mitigate emerging risks. We take these actions in order to maintain the safety and soundness of credit unions, safeguard the NCUSIF, protect consumer deposits, and ensure that taxpayers never experience a loss.

When regulatory actions increase, there typically is an associated increase in complaints against the regulator. Through the mechanisms noted earlier in this testimony, NCUA works to minimize complaints and address appeals expeditiously when they occur. Moreover, NCUA has had in place since 1995 a non-retaliation policy to ensure that credit unions can raise concerns without fear of experiencing retribution from the regulator.

VI. Analysis of H.R. 3461

To address issues identified in the Subcommittee's recent hearings, H.R. 3461 would institute new examination procedures, modify accounting practices, and create new appeal venues. Although well intentioned, the bill in its current form could produce a number of unintended consequences. Our testimony will focus on three of these unintended consequences—increased administrative costs, higher risks for the NCUSIF, and the imposition of an inflexible, one-size-fits-all approach in the examination of financial institutions.

Increased Costs for NCUA

First, H.R. 3461 would greatly raise NCUA's administrative costs. For example, the legislation's requirements to index and produce information supporting a finding would increase the time spent on examinations. The legislation's expansion of the existing definition of a "material supervisory determination" also would make virtually all examiner findings, recommendations, and action plans subject to formal appeal. In response, NCUA examiners would need to document each and every finding with specific references to NCUA rules and regulations. Additionally, at a time when NCUA is actively moving to shorten the timeframes and curtail regulatory burdens for the smallest credit unions, H.R. 3461 would force examiners to spend more time on these examinations.[4]

[4] In order to better align agency resources with industry risks, NCUA is implementing the Small Credit Union Examination Program (SCUEP) that shifts examination hours away from smaller federal credit unions with a record of sound performance and towards those credit unions that present more risk to the NCUSIF. The SCUEP is limited to

Today, NCUA operates with an extremely efficient organizational approach. We deploy our subject matter experts as a shared resource and do not assign these experts to every examination. This organizational structure reduces costs to the agency and these reduced costs are passed on to the industry.

Examinations requiring the assistance of a subject matter expert may occur through direct in-person participation or via informal consultation through phone conversations and email exchanges with the examination team. While many of these interactions are consultative in nature, they could be considered a portion of the source for reaching conclusions in an examination. If so, then the bill's documentation requirements would result in the need to index and share these sources—email chains, notes of conversations, and phone logs—with the credit union. NCUA, therefore, believes that the bill, as introduced, could be disruptive to our existing internal consultation process and possibly stimulate greater appeals to examination findings, both increasing risk to the NCUSIF and costs to the industry. The changes may also cause examiners to seek subject matter experts in less significant risk cases as a defensive measure to ensure that issues are not challenged. In either event, the net result would be higher administrative costs for the agency.

Moreover, the legislation's provisions to create additional appeals processes would add more regulatory layers that would increase costs without any assurance of greater effectiveness. Again, this change would cause examiners to fully document each and every finding, and examination costs would increase.

Currently, much of an examiner's findings are based on sound judgment and sound business or industry practice. The changes proposed in the bill, however, would likely cause NCUA to issue numerous new prescriptive regulations in order to provide examiners with sufficient support for prudential-related concerns that are currently

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federal credit unions with $10 million or less in assets that received a CAMEL composite rating of 1, 2, or 3 at the last examination. The target average examination time for SCUEP examinations is 40 hours.

scaled using professional judgment, based on the size, complexity, and level of risk within the individual credit union. The need to issue new rules and regulations would run counter to NCUA's Regulatory Modernization Initiative adopted in response to Executive Order 13579.[5]

For example, there is no hard-and-true formula about proper asset diversification. Today, if an examiner looks at a credit union's books and sees too many mortgages with only a three percent down payment or inappropriately large mortgages, he or she will warn of overconcentration in the exam report. If, however, a credit union appealed this finding to an administrative law judge as allowed under the bill, NCUA could not point to the violation of a specific regulation, other than citing the fact that overconcentration is an unsafe and unsound practice.

H.R. 3461 would therefore require NCUA to set all such limits in regulation, leaving the examiner with less flexibility. These new regulations would require increased time and resources to implement. Such new regulations would also limit diversity in credit union business models and increase administrative burdens and compliance costs.

Moreover, NCUA would need to significantly increase legal staff in response to allowing credit unions to appeal examination findings to administrative law judges. These cases may also include expert witnesses and would tie up the examiner, the supervisory examiner, and regional management. As a result, NCUA would likely need to hire additional staff to make up for the lost time of preparing and testifying in addition to the new attorneys. NCUA has further apprehensions that H.R. 3461, in its present form, could lead to frivolous appeals, and such appeals would increase costs NCUA's operational costs and cause the loss of significant amounts of time. The Subcommittee may therefore want to consider adding safeguards to prevent this problem.

[5] In issuing Executive Order 13579, President Obama ordered independent regulatory agencies to periodically review existing significant regulations for those that may be "outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them" accordingly. Through the Regulatory Modernization Initiative, NCUA is working to improve the regulatory environment by ensuring that NCUA rules are in sync with the modern marketplace, clearly written, and targeted to areas of risk. NCUA is also working to eliminate regulations that limit flexibility and growth without jeopardizing safety and soundness.

In addition, the bill's ombudsman and operational funding formula changes would significantly increase NCUA's expenditures for the FFIEC.[6] NCUA has historically paid for one-fifth of the FFIEC's operations. H.R. 3461 correctly removes the Office of Thrift Supervision from shouldering a portion of the FFIEC budget, but the bill fails to reassign this share to the FFIEC's newest member—the Consumer Financial Protection Bureau (CFPB). As reflected by the 2012 FFIEC budget, CFPB is now fully participating in the cost-sharing of the FFIEC expenses. Left unchanged in the bill, NCUA's expenditures for the FFIEC's costs and expenses will increase from 20 percent to 25 percent.

The bill also requires the FFIEC to establish an ombudsman and appeals process involving administrative law judges. This change would likely result in a large addition to the FFIEC staffing levels depending on the number of requests for reviews and the time needed to investigate complex issues. In short, these changes would increase the costs of all FFIEC members that pay for the FFIEC's activities.

In previously requiring NCUA and federal banking agencies to establish independent, intra-agency appeals panels, Congress placed limits on the issues that financial institutions could appeal. Specifically, the Riegle Community Development and Regulatory Improvement Act of 1994 stipulates that credit unions may only appeal determinations related to examination ratings, allowances for loan and lease losses, and classifications on loans significant to a financial institution. H.R. 3461, as introduced, would expand the definition of a material supervisory determination to include any issue specifically listed in an exam report as a matter requiring attention by the institution's management or board of directors. This change would encourage appeals on virtually any and all issues because there would be no limitations on such actions.

[6] NCUA Board Chairman Debbie Matz became the FFIEC Chairman in April 2011. The FFIEC chairmanship has a two-year term.

In sum, NCUA expects the administrative and regulatory costs imposed by H.R. 3461 to be considerable. Ultimately, credit unions and their members would pay for these increased expenses.

Increased Risks for the NCUSIF

Second, H.R. 3461 in its present form appears likely to greatly increase risks to the NCUSIF. Increased risks to the NCUSIF would result in higher insurance losses and higher premiums for credit unions in the future.

The changes to examination standards dealing with commercial loan non-accrual status and restoration to accrual status, for example, have the potential to mask problems and extend the time before NCUA may take needed supervisory action. Specifically, the new Section 1013 of the Federal Financial Institutions Examination Council Act of 1978 proposed in H.R. 3461 essentially codifies in statute income recognition and loan loss provisioning rules more appropriately within the purview of the accounting standards-setters. If adopted, such practices may result in a credit union continuing operations beyond a point where NCUA would normally take action to mitigate insurance losses because of a hindrance in full transparency around loan non-performance. This change could keep NCUA in the dark about existing credit risk at credit unions. As a result, the NCUSIF would likely incur larger insurance losses.

The bill's provisions on non-accrual status are generally consistent with current accounting and financial reporting practices. Yet, because these provisions create bright lines that may permit financial institutions to ignore other available information about the borrower that should be properly factored into evaluations of a commercial loan's collectability, there is a risk that some institutions may game the system by structuring loans in a way to make it more difficult to properly provision for losses. For instance, the ability-to-perform language in the restoration to accrual paragraph goes beyond current practice when the commercial loan does not have monthly repayment terms. Under current practice, financial institutions must evaluate the probability that

the loan will be repaid according to contract terms. Financial institutions must also value the loan accordingly using generally accepted accounting principles (GAAP). Likewise, to maintain accrual status, the loan should be well secured and in the process of collection. Any restructured loan must generally remain in non-accrual status for six months and the borrower must demonstrate repayment performance under the modified terms before the loan can be returned to accrual status.

To ensure harmonization with GAAP, the Subcommittee may want to clarify these issues. In this regard, the Subcommittee may wish to consider the views of the Financial Accounting Standards Board (FASB) before moving forward with consideration of the bill. FASB would be in a position to provide full insights on financial reporting impact of the proposed bill.

The new Section 1013(a)(3) is unclear, in part, because the provision fails to specifically refer to a refinance in the language limiting a new appraisal for a commercial loan. The section, however, suggests the institution is taking action. In cases where an institution is involved in a loan restructuring with no cash out, the bill would prohibit NCUA from expecting the credit union to evaluate risk exposure through requiring appraisals of the properties in question. Historically, a bank or credit union would normally require a new appraisal as part of its underwriting on the modified loan. More current value information is critical to appropriately assess the reserving needs for impaired loans.

The limitations on obtaining a new appraisal would likely increase the risk of loss to the NCUSIF because NCUA would have less knowledge about the value of collateral on an impaired loan. When a credit union depends solely on the sale of collateral for repayment, the proper valuation of the collateral—often obtained through a new appraisal—is critical to assessing risk and capital exposure.

The new Section 1013(c) would further require NCUA and the banking regulators to develop identical definitions and reporting requirements for non-accrual loans. FFIEC agencies would therefore have to develop and apply a uniform definition to all financial

institutions, regardless of size or activities. For many years, NCUA has tied the definition of non-accrual to GAAP, as required by the Credit Union Membership Access Act of 1998 (P.L. 105-219). In January, the NCUA Board issued for public comment an accounting Interpretative Ruling and Policy Statement that will further modify the definition of non-accrual. The bill's requirements to apply identical definitions and reporting requirements for non-accrual loans would have a real impact on NCUA, and a significant change in this area could have a material cost impact on every credit union requiring needed changes to data processing systems.

NCUA also has concerns that the administrative law judge and FFIEC ombudsman appeals processes would produce greater uncertainty in the examination process. For example, the recommendations of administrative law judges and the decisions of the FFIEC ombudsman do not have to accord deference to agencies' actions and could result in the overturning of precedent. Additionally, the bill does not contain procedures for handling instances when two different administrative law judges issue two different recommendations in substantially similar cases. Besides problems related to inconsistency, an administrative law judge's recommendation to overturn a safety and soundness action due to a lack of knowledge of financial institution operational risk on a forward-looking basis might result in greater insurance losses in the long term.

In addition, NCUA is greatly concerned that any appeals to an administrative law judge could lead to public hearings with no confidentiality granted to the subject matter unless the bill is further clarified. Public hearings featuring the release of confidential supervisory information could easily become reported by the press or posted on the internet and, in the worst case, cause members to rethink their choice in financial services providers in an institution that NCUA is working to strengthen.

NCUA has continued to emphasize and reinforce a forward-looking view of risk to effectively steer institutions away from catastrophic outcomes. This examination approach requires an examiner to prospectively consider the long term and future impact of current decisions and trends when making recommendations or developing

action plans based on those judgments. Under the proposed law, we believe examiners would become less inclined to make a more forward-looking assessment of risk. Instead, they would approach nuanced institutional business models with an assessment that is less tailored to the unique business model, strategy, and consumer base of a specific institution.

NCUA also believes that the proposed appeals system could increase the risk of NCUSIF losses through delayed action as the process advances. Additionally, the legislation's independent appeals process would sidestep the critical communication process and dialogue that occurs between examiners, NCUA's leadership, and regulated institutions. As a result, NCUSIF risks could increase.

Moreover, the increased time to settle issues runs counter to a recent GAO recommendation that NCUA "require early and forceful regulatory action" well before capital deterioration triggers prompt corrective action.[7] The provisions in H.R. 3461 would require greater documentation for all examinations to insure proper preparation for any appeals to an administrative law judge or the FFIEC ombudsman for potential appeals.

In sum, unless modified, H.R. 3461 could significantly increase risks for the NCUSIF, and credit unions would pay higher premiums for the associated losses.

One-Size-Fits-All Examination Approach

Third, H.R. 3461 would produce a one-size-fits-all system for financial institution supervision as a result of the requirement to establish consistent examination standards across regulators. This change would decrease regulatory flexibility and add considerable costs, especially for small credit unions.

[7] See *National Credit Union Administration: Earlier Actions Are Needed to Better Address Troubled Credit Unions* (GAO-12-247).

NCUA currently customizes its reviews based on the size, scale, and scope of each credit union. This customization of examinations provides flexibility and helps to decrease examination costs for the smallest of credit unions.

The largest bank holding companies have more than $1 trillion in assets, yet nearly 70 percent of credit unions have $50 million or less in assets. The requirements to establish consistent examination standards across regulators will decrease regulatory flexibility and require similar treatment for all institutions regardless of size.

The smallest credit unions offer basic banking services like taking deposits and making small personal loans to members. Many of these credit unions have a very small or part-time staff, along with very limited resources that are already imposed upon during examinations. These small credit unions would be harmed by the implementation of uniform examination standards for all banks and credit unions.

NCUA has been actively working to reduce the regulatory burden on credit unions and develop a forward-looking regulatory approach that seeks to anticipate the risks to which individual credit unions are subject. NCUA is concerned that the requirement of consistent industry-wide examination standards contemplated in H.R. 3461 would reverse these efforts to ease the regulatory burdens of smaller credit unions.

VII. Conclusion

In sum, NCUA recognizes that financial services regulators must conduct exams fairly and consistently, and we strive to achieve this standard. NCUA is also committed to addressing legitimate concerns about the present exam process, minimizing regulatory conflicts, promoting procedural fairness, and advancing exam consistency.

Later this year, for example, NCUA will adopt a National Supervisory Policy Manual to replace regional policies that dictate procedures. In addition to enhancing the consistency of NCUA examinations, this manual will retain the necessary flexibility that

examiners need when conducting examinations of both the largest and smallest credit unions, which range in size from less than $1 million to more than $45 billion.

While economic conditions and business models change, regulators must work to ensure that the institutions they oversee are well aware of the risk of their business and are properly protected against losses when circumstances change. NCUA must also balance competing concerns in order to protect safety and soundness and limit risks to the NCUSIF.

As introduced, H.R. 3461 would significantly increase administrative costs and insurance risks, and decrease regulatory flexibility. NCUA respectfully requests that the Subcommittee carefully weigh these concerns against the laudable goals of increased transparency and additional rights for financial institutions. The Federal Credit Union Act requires NCUA to ensure that credit unions are operated in a safe and sound manner. NCUA believes that this legislation will make that mission much more expensive and difficult.

The additional appeals processes would also create new conflicts in exams and encourage frivolous legal challenges. The Subcommittee might consider inserting provisions that impose penalties for appeals deemed to be frivolous by the ombudsman or the administrative law judge and also make such appeals possible only after the existing appeals process has been exhausted. While this does not address all of NCUA's concerns with these provisions, these improvements will go a long way to reducing unintended consequences.

NCUA is committed to working with Congress to explore these issues and other ways to address concerns about the examination process. We look forward to your questions.