NASCUS

June 13, 2016

The Honorable Rick Metsger
The Honorable J. Mark McWatters
National Credit Union Administration
1775 Duke Street , Alexandria, VA 22314-3428

Dear Chairman Metsger and Board Member McWatters:

I commend you, Chairman Metsger, for introducing the "Board Briefing" option to NCUA Board meetings and I commend you, Board Member McWatters, for embracing the practice. This procedural innovation promises to provide both the NCUA Board and credit union system stakeholders with a valuable platform for considering relevant information ahead of possible future NCUA rule-making.

Noting that "Interest Rate Risk Supervision and Adding 'S' to CAMEL" is on the agenda for this week's Board meeting, NASCUS is pleased to provide the Board with both historical background from States and an update on State supervisors' utilization of "Sensitivity to Market Risk" in the supervision of state-chartered credit unions.

As the Agency is aware, FFIEC first approved the addition of "S" to the Uniform Financial Institutions Rating System (UFIRS)—also known as CAMEL—on December 9, 1996 and CAMELS was adopted by all Federal supervisory agencies except NCUA to take effect January 1, 1997. Since that time State supervisory agencies have rated the "L" and "S" components individually when examining State-chartered banks. Because this approach has served both State banks and State regulators very well over the past two decades, many State supervisory agencies have extended the use of "S" to State-chartered credit unions.

NASCUS is aware of 14 states that have previously implemented "S" and 2 states that will begin utilizing "S" in 2016:

State	**Adoption of CAMELS**
Colorado Connecticut Maine Massachusetts Michigan Mississippi Montana Nebraska Nevada New Hampshire Texas Utah Vermont Washington	Adopted prior to June 2016
Wisconsin	Effective July 1, 2016
Idaho	For exams commencing after October 1, 2016

In addition, we are aware of 5 states that are considering adding "S" to "CAMEL." Please note that NASCUS is currently undertaking its biennial profile survey of States and we expect to have a more comprehensive listing of States that have implemented "S" by the end of July.

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In those States that have previously adopted CAMELS, both regulators and credit unions report positive outcomes with little if any additional regulatory burden. In practice, State supervisors have continued to use the same examination procedures for assessing liquidity and interest rate risks; however, by rating the “L” and “S” components separately—rather than in a combined component—State regulators have been able to provide better information to credit unions to clearly delineate analysis between liquidity risk and interest rate risks. From a credit union perspective, an “S” rating is no longer masked by a stronger “L” rating nor is an “L” rating “dinged” by a weaker “S” rating; conversely, an “L” rating is no longer masked by a weaker “S” rating nor is an “S” rating “dinged” by a weaker “L” rating.

At the 2014 NCUA-NASCUS National Dialogue in Pittsburgh, State supervisory agencies first shared their positive experiences of utilizing “S” in State-chartered credit unions. It was at this joint meeting of NCUA-NASCUS where the initiative of adopting CAMELS more broadly for the national credit union system first took root--a result of constructive State-Federal discussion and collaboration.

Earlier rather than later adoption of “S” is prudent. State examiners—and NCUA examiners, to be sure—have observed that the extended low-yield environment continues to encourage greater risk-taking by financial institutions. Across the nation, historically low net interest margins have led some credit unions and their bank peers to “reach for yield” by increasing their holdings of longer-duration assets or by engaging in other forms of increased risk-taking to maintain earnings. Furthermore, the anticipated rising rate environment may adversely affect earnings, net worth, net economic value as well as the market value of liabilities. With investment income, loan income, and share dividends all being interest-sensitive, credit union earnings may be affected. In short, it behooves credit unions and their regulators to monitor “Sensitivity to market risk” separately from liquidity risk *before* rates start to rise—not after the fact.

By year-end 2016, at least 16 State credit union supervisory agencies will—and another 5 may—have implemented the “S”. We understand from recent NCUA statements that the Agency desires to implement the “S” rating for federally-insured credit unions by year-end 2018. For the reasons stated, above, NASCUS and State supervisory agencies encourage NCUA to consider earlier adoption of “CAMEL**S**”. We again note that the separation of the “S” component does not require a credit union to develop additional management system enhancements where market risk is already appropriately identified, measured, monitored and managed as part of the “L” component.

NASCUS hopes that the NCUA Board finds this update informative. We would be happy to share States' specific experiences in adopting “CAMEL**S**” over the last several years, should the Board and Agency staff find this useful.

Sincerely,

– *signature redacted for electronic submission* –

Lucy Ito
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