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Gerald Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, CA 22314-3428

Prompt Corrective Action – Risk-Based Capital Comment Letter

Patelco Credit Union appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposed rule, Prompt Corrective Action - Risk-Based Capital.

Like most credit unions, Patelco was founded to serve the financial interests of employees of a particular organization – in our case the **Pa**cific Telephone and **Te**legraph **Co**mpany (now part of AT&T). The year was 1936, and Patelco's initial assets totaled a mere $500. We have expanded our field of membership to serve the employees of over 1,000 large and small businesses and communities throughout California and the United States. With assets now totaling more than $4 billion and 277,000 members nationwide, we are among the largest credit unions in the nation today.

Although we agree that the present capital rule is outdated and inadequate for the credit union industry, we believe that the proposal does not provide a suitable alternative. More importantly, the proposal provides barriers to the credit union business model inhibiting credit unions from fulfilling their mission to serve the needs of their members. The following are specifics comments we have regarding the proposal.

The effect of the proposal:

Patelco currently maintains a capital (net worth) level of 11.90% of total assets, a buffer of almost 5.00% above the "well capitalized" level. While under the proposed rule, our risk-based capital level would be 18.00%, a buffer of 7.50%; this is only good for a point in time and may not support the future needs of the Patelco membership. Additionally, the effect on the credit union industry appears to be quite different. Over two-thirds of the nation's credit unions would suffer reductions in their capital buffer over the "well capitalized" level. CUNA estimates that this equates to a reduction of $7.3 billion in this capital buffer.

Notwithstanding the industry impact, we are focused on the future opportunities for Patelco and the impact that the new ratio would have on growing existing business lines or new ones that may be in our future.

Although a new rule is necessary, we believe this proposal has significant flaws. Among them are:

- No consideration of balance sheet liabilities is provided, which would mitigate certain risks in asset classes. There is no use of a leverage ratio concept. This dis-incents credit unions from making mortgage loans, member business loans, or holding long-term investments; thereby not serving the membership and communities effectively. Effective balance sheet management considers the leverage aspect of the liability side of the balance sheet. Many credit unions raise term certificates of deposit, which provide a natural hedge against rising interest rates; or they mitigate interest rate risk with a borrowing or derivative strategy. Without the consideration of these mitigating features, the proposed rule can easily overestimate the interest rate risk of the credit union, and create unreasonable and unnecessary added capital requirements. Again, this is not in the membership's best interest as it will lead to the avoidance of longer term assets in many credit union business strategies, thereby reducing consumer choice for these assets.

- Different asset classes address different risks, which appear to be very selective and generally inconsistent with the risk profiles of credit unions. Sections address concentration risk, others interest rate risk, and yet others focus on credit and other risks. This appears more complex, and quite frankly convoluted, than is necessary given the experience with BASEL requirements over the years in the banking system. The following example demonstrates the interaction of the first mortgage loans and investments and the effect of the proposed risk based capital ratio: As a theoretical business strategy, if Patelco would desire to portfolio $500 million in current 30-year fixed rate First Mortgage loans, it would increase interest rate risk, its credit risk, and its concentration risk. In doing so, we would move from 24% of assets to 36.5%. All but $26 million of the increase would now be rated at the higher 75% or 100% risk weight. Instead of increasing asset size, we decide to liquidate $200 million of investments with an average weighted life of 3-5 years and $300 million at 5-10 years. This would reduce only interest rate risk in the proposed risk based capital ratio. Although the total risk to the balance sheet seems to be increasing in several areas, our risk based capital ratio would actually increase from 18.00% up to 19.69% under the proposal. If Patelco were to prefer to hedge the mortgage loans with term liabilities, there would be no benefit in doing so under the proposal, although this may be a better interest rate risk mitigation strategy.

- The new rule is "layered" upon the existing PCA rule rather than replacing it. As a result, a dual test requirement is created. Without considering liabilities and the use of a leverage ratio, this dual test system is not an accurate representation of capital risk. Rather than replacing the existing net worth requirement, the proposed rule adds another layer to this existing requirement unlike what is done for banks. Since the two use different risk factors, (some favorable and some not) this adds an element of mixed guidance to the management of the balance sheet. Under the current system, the buffer is the difference between a credit union's net worth ratio and either 7 percent or the RBNW requirement, whichever is higher. Under the proposed "risk-based capital system" and Basel, the buffer is the lesser of the difference between the credit union's net worth ratio and 7 percent (in dollars) and the difference between the credit union's risk-based capital ratio and 10.4 percent (in dollars).

- The risk weight for CUSOs appears to be punitive in nature treating all CUSOs the same regardless of business lines, their financial position, or their ownership structure. Despite a few CUSO failures, many CUSOs remain viable and provide creative and innovation solutions for credit union members as well as efficiencies among the credit union movement. Patelco envisions having an insurance CUSO in its future, which would require capitalization. We also see the potential to evaluate small business lending. The proposed rule focuses on all CUSO's and treats them all with a sense of heightened risk. The proposal for CUSO capital is extreme and again not warranted, as is the different levels of capital for certain assets....such limits create a competitive disadvantage and create earnings risk. In many ways, the inter-agency guidance on interest rate risk is already accounted for and under regulatory scrutiny – this places excessive risk-based capital burdens on long-term assets, is redundant, and not necessary.

- Although there is a desire for consistency with equivalent bank requirements, the proposed requirements are much more restrictive and punitive than the standard Basel III framework. Without parity with the bank system, it disadvantages credit unions in the marketplace and may ultimately force fee increases, etc. to compensate for earnings loss and the unnecessary building of capital (based upon the proposal), which is not in our members best interests. The biggest disadvantage to the CU industry is the full and sudden implementation of the new capital reserve requirements, instead of a phased-in approach used in the Basel framework. This will put credit unions at an *immediate* disadvantage because more of their capital will be required at once, which will result in less loans to members and less income generating investments for the credit union. The other difference between Basel and the proposed requirements relates to the types of risks addressed by each and the amount of capital required for certain assets. While there are some advantages provided to credit unions, because Basel has higher capital requirements for consumer loans and small concentrations of other loans, credit unions are disadvantaged because the NCUA proposed capital requirements are more extensive and cover several types of risk factors (i.e. concentration risk, interest rate risk, credit risk, etc.), whereas the Basel system only covers credit risk.

- Additionally, other NCUA rules are in place that are more conservative than those in the banking system, creating a "less-risk" environment for credit unions in general as compared to the banking system. Implementing a higher standard for risk-based capital that places an additional capital burden on credit union is not commensurate with the level of risk in the industry, nor is it necessary.

- Finally, we disagree with the NCUA's ability to require a higher minimum risk-based capital ratio for an individual credit union on a case-by-case basis. Such authority would be over and above the objective risk-weighting system calculation implicit in the proposal. As such, the NCUA's determination of whether a credit union would be subject to an individual minimum capital requirement would of necessity be highly subjective.

Given the many concerns with this proposal and the dramatic, adverse effect it would have on credit unions, we feel that the rule as proposed needs to be re-evaluated. Additionally, the 90-day comment period is insufficient for a proposal that is this impacting and we would recommend a minimum of 180-days. We also would prefer a multi-year timeline for implementation when effective. The timeline should provide for a phased-in approach, similar to Basel III, as opposed to a firm effective date for all.

Thank you for the opportunity to comment on this proposed rule and for considering our views on risk based capital requirements.

Patelco Credit Union

Erin Mendez

Erin Mendez, Chief Executive Officer

Peter Hanelt

Peter Hanelt, Chairman of the Board