ECCU

MAY05'14 PM 1:42 BOARD

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

Re: Comments on Proposed Rule: PCA – Risk Based Capital (RBC) Proposed Rule

We appreciate the opportunity to express our viewpoint on this proposed rule. We are focusing on the amendment to part 702 of NCUA's regulations regarding prompt corrective action (PCA). Educational Community Credit Union (ECCU) is a Michigan State Chartered Credit Union with $415 million in assets.

There are eight major areas of concerns ECCU has with the proposed rule as listed below:

- Risk Weightings
  - Mortgage Loan Weights
  - Investment Weights
  - Investment in CUSOs Weight
  - Corporate Perpetual Capital Weight
  - Mortgage Servicing Assets Weight
- Interest Rate Risk
  - Assets
  - Liabilities
- Definition of Complex
- Data Collection
- Discretionary Supervisory Action
- Strategic Planning Process
- Need to Change Current Regulation
- Implementation Time Frame

RISK WEIGHTINGS

The NCUA risk weightings on various assets are significantly different than Basel III for small banks. Although there are many categories that are different, we are only focusing on five of them.

Mortgage Loan Weights

As of December 31, 2013 and March 31, 2014 our mortgage portfolio (1st Liens) were $172 million and $171 million, respectively. The breakdown of the mortgage products are below:

			Percent of Assets	Percent of Assets
Balloons	12/31/2013	3/31/2014	12/31/2013	3/31/2014
5 Yr Balloon	14,587,609	14,077,971	3.65%	3.40%
7 Yr Balloon	4,918,214	4,894,202	1.23%	1.18%
15 Yr Balloon	866,895	847,559	0.22%	0.20%
Total Balloon	20,372,718	19,819,732	5.09%	4.79%
Fixed Rate				
7 Yr Mortgage	0	355,880	0.00%	0.09%
10 Yr Mortgage	67,639,177	64,719,801	16.91%	15.63%
12 Yr Mortgage	21,956,488	23,124,121	5.49%	5.58%
15 Yr Mortgage	17,404,915	16,694,936	4.35%	4.03%
20 Yr Mortgage	8,058,773	7,684,913	2.01%	1.86%
30 Yr Mortgage	36,611,276	38,612,062	9.15%	9.33%
Total Fixed Rate	151,670,629	151,191,715	37.92%	36.51%
Total First Mortgage	172,043,347	171,011,447	43.01%	41.30%
NCUA RBC Assets	112,047,945	108,901,021		
BASEL III Assets	86,021,674	85,505,723		
Difference	26,026,271	23,295,298		

This table shows the large difference of capital required between the proposed NCUA regulation and the BASEL III regulation. The table also shows that within the fixed rate mortgages the largest concentration of balances are in the 10 year fixed rate mortgage which has a ½ life of 5 years and a duration of approximately 3 years. The proposed regulation does not take into consideration the term of the mortgages, nor the years to maturity, which we believe it should. A 30 year mortgage is not the same as a 10 year mortgage when considering, IRR, Liquidity Risk, Market Risk, Concentration Risk, or Asset Quality Risk and a 30 year mortgage originated on December 31, 2000, no longer has 30 years to maturity.

In addition, the proposed change assigns a zero percent risk weighting to Treasury securities. We could, in theory, stop originating 10-year mortgage loans and buy 30-year Treasury securities and reduce our RBC requirement. This would add IRR exponentially.

Mortgage Loan Weights (continued)

We suggest either using the Basel III weighting, or change the information reported on the CALL report to better define the maturities and/or use the years to maturity method of the mortgages to assign weights accordingly vs. rating all mortgages the same.

Investment Weights

There are two concerns with the investment portion of the proposed RBC.

The first is that Direct U.S. Government Obligations have a zero risk weighting (as noted above) vs. the WAL risk weighting for all other investments. This, in theory, could incent us to purchase 30-year Treasury securities to obtain that zero risk weighting vs. purchasing any other type of investment. This is counterproductive to managing IRR.

Secondly, the risk weights assigned to the various WAL of investments seem to be arbitrary when compared to the Basel III weightings. NCUA is requiring up to 200% risk weighting on investments while Basel III only requires 20% for any investment, regardless of maturity. There does not seem to be parity here.

Again, we show our actual investment portfolio weighted average life (WAL) as of 12/31/2013 and 3/31/2014 and the dollar difference between NCUA RBC and Basel III RBC

Investment	Balance 12/31/13	Balance 3/31/2014
WAL up to 1 Year	14,168,166	10,902,116
WAL 1-3 Years	25,182,555	11,544,117
WAL 3-5 Years	12,949,010	14,301,836
WAL 5-10 Years	4,056,519	22,891,014
WAL over 10 Years	-	898,201
	56,356,250	60,537,284
NCUA RBC	31,221,447	54,811,782
Basel III RBC	11,271,250	12,107,457
Difference	19,950,197	42,704,325

It is understandable that the NCUA is nervous about interest rate risk related to investment securities for credit unions, but it should be looked at through an examination perspective, and not solely based on one criteria. Currently that criteria is the "industry standard calculations" or the Bloomberg Median average life estimate. Relying on just that measurement it could appear that ECCU has higher IRR on the balance sheet.

When we look at the combined mortgage and investment portfolios, it would be easy to argue that the IRR taken by ECCU is not exceedingly high.

Risk Weightings (continued)

We would suggest either using the Basel III weighting. Limiting the investments to short term, or only direct U.S. government obligations would negatively affect credit unions.

Between the mortgages and investments ECCU is penalized by having "higher risk" based assets of $45,976,468 and $65,999,623, respectively.

If the main reason for the weightings is risk mitigation, we would rather have a system in place where the weightings are the same as the Basel III and have more examiner interaction. We suggest that if a credit union is deemed to have "high interest rate risk" that the NCUA utilize their capital market specialists to conduct quarterly or semi-annual examinations. This added layer of review in addition to the normal examination process should give the NCUA more confidence on the credit unions ability to continue to provide the products and services required for their membership.

Investment in CUSOs Weight

This risk weighting appears to be arbitrary. CUSOs assist in keeping the cooperative movement moving forward. Why would there be a need to penalize credit unions 2.5 times their investment for this support? This could incent credit unions to not pursue CUSO opportunities, or even possibly pulling their investments out of current CUSOs.

We would suggest a 100% risk weighting, similar to the "all other assets" category.

Corporate Perpetual Capital Weight

The industry went through the recapitalization of the corporate credit unions. With the proposed RBC we are being penalized for that recapitalization. The 200% risk weighting appears to be arbitrary. In the event that a corporate goes under we are at risk of losing our perpetual capital, so why not use a 100% weight against it?

We would suggest a 100% risk weighting, similar to the "all other assets".

Mortgage Servicing Assets Weight

Although this is not a large dollar amount for ECCU, why does the NCUA feel that credit unions have to differ from Basel III for mortgage servicing rights?

We would suggest a 100% risk weighting, similar to the "all other assets", unless the servicing asset grew to over 10% of the reported net worth. At that time, the weighting could move to 250%, similar to BASEL III.

INTEREST RATE RISK

Assets

As noted previously, the NCUA is trying to regulate interest rate risk solely through the CALL report, which we do not find to show an accurate picture of an individual credit unions interest rate risk. There are many components to interest rate risk, not just mortgages and investments. The proposed rule is trying to regulate assets that, are at the present, viewed as risky. But, the NCUA has ignored the risk associated with long-term Treasury securities. We would much rather originate a 15 year mortgage to our member than purchase a 15-year bullet Treasury security.

Liabilities

There are three components of the Balance Sheet, but the proposed RBC only highlights two of them. The RBC considers the assets and the equity of the institution, but does not consider any liabilities that are associated with the institution.

There is no place in the proposed RBC that highlights the liability transactions that reduce the interest rate risk associated with the mortgage and investment activities noted above although some of the information is collected in the CALL report.

There is no consideration of borrowing to offset long term interest rate risk in the mortgage/investment portfolio or consideration of deposits that have the same effect as borrowing to offset long term assets. The NCUA has always considered Non-maturity shares to have a life of less than 1 year, which is not at all accurate.

Based on a core deposit study we had performed by a third party, we have approximately $58 million in “core deposits”. We would be happy to obtain more than one study from independent third parties to determine the accuracy of this dollar amount.

We suggest, at a minimum, if the proposed regulation weighting for mortgage and investments are left unchanged, that the Board determine a weighting that shows the value of the liability items on the Balance Sheet.

DEFINITION OF COMPLEX AND DATA COLLECTION

The federal bank regulatory agencies define small bank, small savings association, intermediate small bank, and intermediate small savings association as those that have assets as follows:

- "Small bank" or "small savings association" means an institution that, as of December 31 of either of the prior two calendar years, had assets of less than $1.186 billion.
- "Intermediate small bank" or "intermediate small savings association" means a small institution with assets of at least $296 million as of December 31 of both of the prior two calendar years, and less than $1.186 billion as of December 31 of either of the prior two calendar years.

Give the above definition, we would argue that a small credit union would be able to be defined as at least $250 million in assets and smaller. To have complex credit unions be defined as those with greater than $50 million in assets seems counter-productive to easing regulatory burden.

In addition, from a cost benefit analysis, credit unions under $250 million have had less of a negative impact on the NCUSIF than larger credit unions in recent years. There has not been an NCUSIF premium assessment since November 2009.

Also, the NCUA appears to not want to increase the amount of reporting required by credit unions within the CALL report. As was stated above, having such a small asset size be deemed complex appears to be counterproductive to this goal.

We suggest modifying the definition of complex from the $50 million asset threshold to $250 million to be more in line with the banking industry and reduce the cost of regulation to the smaller asset size institutions.

DISCRETIONARY SUPERVISORY ACTIONS

We are concerned that an examiner has complete discretion of requiring ECCU to hold additional capital because, in their view, we should have additional capital. We understand that there are situations that would give examiners pause in how any particular credit union operate, but we have always been under the impression that is where CAMELS ratings came in. In addition, the NCUA has many tools to require a credit union to increase its capital level without having to explicitly state it in the proposed RBC.

We would suggest eliminating the explicit ability for examiners to have discretionary control over any particular credit unions RBC requirement.

STRATEGIC PLANNING PROCESS

Based on the NCUA RBC as of 12/31/2013 we had a RBC ratio of 11.61%, which is well above the 10.5% required. However, we have tried to maintain a "cushion" above the current minimum net worth ratio of 7% to be Well Capitalized. If we were to try to maintain that same "cushion", we would need to have a RBC ratio of over 12%. Would the examiner in charge determine we weren't really well capitalized because we were close to 10.5%?

Also, if our mortgage portfolio continued to grow at historical rates (which helps our members get into homes at affordable rates without undue interest rate risk to us because of our 10 year mortgage product), we would end up falling below the 10.5% ratio in a few years. That takes the strategic planning session process from determining what is best for our members to determining how we can maintain a RBC above 10.5%.

If the proposed RBC regulation were to pass in its current state, there could come a time within the next 5 to 10 years that ECCU may need to consider a charter conversion to serve our members.

NEED TO CHANGE THE CURRENT REGULATION

On April 8, 2014, the Federal Reserve Board, the FDIC, and the OCC adopted a final rule to strengthen the leverage ratio standards for the largest, most interconnected U.S. banking organizations.

Credit Unions have historically used a leverage ratio to determine required capital levels. With the other banking regulators moving toward this metric, does the credit union industry even need to tackle this new, more complex, metric?

With the exception of the corporate stabilization assessment, there has not been an NCUSIF premium assessed since 2009. Although some credit unions did run into trouble, the premiums held by the NCUSIF were sufficient to cover losses and the NCUSIF did not need additional premiums from natural person credit unions.

IMPLEMENTATION TIMELINE

We feel the implementation time frame is not sufficient. The banking industry has until January 1, 2019 to come into compliance with the Basel III Capital requirements. Yet, the NCUA's implementation period is 18 months after the publication of a final rule in the Federal Register. In our estimation, it would take far longer to adjust our Balance Sheet to ensure future regulatory compliance with the proposed RBC regulation.

CONCLUSION

We understand the desire to reduce risk at an industry level, and applaud the NCUA on this first draft. We believe that the NCUA should bring the industry into closer parity with the banking industry. The industry, as a whole, has weathered the "Great Recession" and has historically been conservative through all economic cycles. This proposed regulation will affect our membership adversely. We would have to eliminate, or greatly reduce the mortgage loans we originate and the investments we purchase lowering our ability to increase net income leading to higher net worth.

We hope that the arguments above assist in helping to revise the current proposal to the benefit of the industry as a whole.

Thank you for the opportunity to comment on this proposed rule.

Sincerely,

Earle D. Shelner II

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Vice President – Finance
Educational Community Credit Union

Cc: House Financial Institutions and Consumer Credit Subcommittee
Senate Subcommittee on Financial Institutions and Consumer Protection
Senator Debbie Stabenow
Senator Carl Levin
Representative Bill Huizenga
Representative Gary Peters
Representative Daniel Kildee