Louisiana
Credit Union League

MAY12'14 PM 2:33 BOARD

May 6, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

Re: NCUA Proposed Risk-Based Capital Rule

Dear Mr. Poliquin:

On behalf of the Louisiana Credit Union League, please accept the following comment letter regarding the NCUA Board's proposed risk based capital rule approved in January 2014. We value the opportunity to provide our thoughts on this far reaching proposed regulation that will impact our industry for decades to come. It is crucial that NCUA get this right and that the final rule is balanced and leaves credit unions not only safe and sound – but also competitive in a dynamic marketplace.

Crucial to the ability to remain competitive, which we feel is integral to a credit union's ability to remain safe and sound, is the opportunity to have access to sufficient capital that would both protect against institutional losses and also provide investment capital for strategic growth and member service.

One of our concerns about this proposal is that we feel it will adversely impact the ability of Louisiana credit unions to have access to their excess capital that would otherwise be available for strategic growth and member service purposes when that capital is above the 7% net worth as a percentage of total assets specified in federal statute and regulation in order to be considered well capitalized. While this proposal may indeed provide additional capital reserves as a cushion against loss, we fear that the potentially negative impact it will have on a credit union's access to strategic capital necessary to remain competitive could actually increase the likelihood of losses in the future.

We believe that experience has proven that it is impossible to separate the ability of a credit union to remain competitive with its ability to remain safe and sound. The two are inexorably intertwined. The capital structure under which credit unions operate must be sufficiently flexible to accommodate both needs.

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For example, there are 44 credit unions in Louisiana with assets over $40 million. While the proposed regulation is only effective at this time for credit unions in excess of $50 million, our analysis took into consideration that those with $40 million or more are likely to be impacted within the next five years.

Of the 44 Louisiana credit unions with assets over $40 million, two would fall from well capitalized to adequately capitalized under the proposed system. None would fall from well capitalized to under-capitalized as the rule is currently proposed. Therefore, we offer these comments not because we have a large number of credit unions that will face corrective supervisory action due to becoming undercapitalized. Rather, our concerns are that these 44 Louisiana credit unions will see the reserves they have accumulated in excess of the well capitalized position shrink by a combined total of $30 million if the rule is finalized as proposed. This is $30 million above the current 7% net worth threshold to be well-capitalized that will no longer be available for strategic investment to help the credit unions become more competitive, better positioned to serve their members and in a position to strengthen their financial positions through managed growth.

These 44 federally insured credit unions now have a cushion over well-capitalized equal to 388 basis points on total assets. Under this proposal, the cushion would decline to 348 basis points. This results in a -40 basis point change in the cushion, an amount equal to fifty percent of the ROA earned by these credit unions in 2013.

A total of 23 credit unions – representing 52% of the state's affected institutions – would see their cushions over well- capitalized shrink if the proposed rule were to become final. The median increase in capital needed to maintain the current cushion above well-capitalized is 56 basis points on assets for these credit unions. In fact, five credit unions would experience a reduction in the cushion above well-capitalized of at least 100 basis points on total assets.

The impact on their ability to strategically invest their own capital in order to be safer, sounder and more competitive in the future will be dramatically impacted by this rule as proposed.

Therefore, we would like to make several recommendations for improvement of the risk-based capital proposal.

Initially, let us state that the Louisiana Credit Union League recognizes that a risk-based capital system for credit unions can be a positive for the credit union charter. We commend the NCUA Board for raising the issue and for being willing to address the need. It is our hope that the comment letters you receive on this matter, both from us and others, will be given serious consideration as a means of improving the proposed regulation.

At present, we feel that the proposed rule is lacking in a number of areas and propose for your consideration several changes we believe will improve the rule considerably.

REMOVE EXAMINER DISCRETION PROVISION. It is absolutely essential that credit unions understand clearly what their capital and net worth expectations will be. This rule already creates a dual system with statutory net worth requirements at 7% of total assets in order to be well-capitalized and now an additional second requirement at 10.5% of risk weighted assets to be well-capitalized. Within itself, this creates a question that must be answered. Which is the more important of the two ratios and which should have the strategic priority in credit union risk management decisions – building net worth ratios through the earnings that come with managed risk of certain higher risk assets or building capital ratios in the risk-based capital regime through divestiture of certain higher risk assets that might be performing well but adversely impact the risk-based capital ratios?

That dual standard, however, is not the end of the management challenge that this proposal provides. In addition to this dual net worth/risk-based capital standard requirement, the proposed rule also provides for another unknown variable for a credit union to consider when trying to figure out the right net worth versus capital ratio mix – examiner subjective discretion.

Under this proposal, an examiner can increase (we note that he or she cannot decrease, only increase) a credit union's individual risk-based capital requirement by subjective action during an examination based upon his or her determination of the need for additional capital versus the balance sheet risk.

In other words, a credit union with 9.5% net worth under PCA and a 14.2% risk-based capital ratio can find itself not in solid regulatory compliance after all. An examiner may, in his or her individual examiner discretion, determine that the credit union actually needs 15.9% risk-based capital.

This presents a lack of management clarity through this proposed rule that makes it totally impossible to strategically manage for compliance. We believe that this provision serves to actually undermine the effectiveness of the entire regulation as, if the examiner can set his or her own risk-based capital ratio requirement on a credit union by credit union basis, there would seem to be no real reason for a regulation establishing a formula of risk weights to which a credit union should manage. It could be issued as guidance and not as a regulation.

We urge the NCUA Board to remove this provision in its entirety.

SUPPLEMENTAL CAPITAL SHOULD BE ADDRESSED. The NCUA's own low-income designation initiative has now made over 2000 credit unions eligible for supplemental capital that can count toward their statutory net worth requirements of 7% of total assets to be considered well-capitalized under existing law and regulation.

Combine with this fact that there is no law or regulation preventing supplemental capital from being sought by all credit unions , it would seem that this regulation is an excellent opportunity for NCUA to draft and put into the final regulation the guidelines and specifications for credit unions to also supplement their risk-based capital. In addition, it could address those over 2000 low income designated credit unions and how they could utilize supplemental capital to build both their risk-based capital and their net worth as well.

It seems that the time is right to address this issue. Capital modernization in name requires the discussion of true capital modernization in fact. Without an industry-wide discussion of supplemental capital through a public comment period, true capital modernization will not take place.

We recommend that the NCUA include a supplemental capital section with this proposed rule and then put the entire proposal back out for an additional public comment period, thereby allowing for the Dodd-Frank "comparability" requirements and ensuing opportunities to be addressed by the NCUA. .

CREDIT UNIONS CHARTERED HISTORICALLY FOR BUSINESS LOAN PURPOSES SHOULD BE EXEMPT FROM CONCENTRATION MULTIPLIERS IN THE RISK WEIGHTING FORMULA. In 1998 when the Credit Union Membership Access Act was passed by Congress, those credit unions originally chartered for the purpose of making business loans (church credit unions, agricultural credit unions, taxi medallion credit unions, etc.) were carved out from the statutory member business lending cap of 12.25% of assets.

These credit unions were set aside as a statutory class of credit unions within themselves. Their history was making business loans. Their purpose was recognized by congressional action. Their concentration in business loans was accommodated as being different from the business loan portfolios being built by other credit unions.

Credit unions historically chartered for the purpose of making business loans, a category already recognized by law and designated as such in the NCUA data base from which the risk-weighted numbers are drawn, should be exempted from the concentration-based increased weights and their entire business loan portfolio weighted at 1.0. We urge the NCUA Board to include such an exemption from the concentration weight increases for this special class of credit unions.

PERFORMANCE IN MORTGAGE AND BUSINESS LENDING RISK MANAGEMENT SHOULD BE CREDITED WITHIN THE RISK WEIGHTING FORMULA. One of the major flaws of the proposed risk weights is the lack of recognition of risk differential among mortgages if the loan has a 75% loan-to-value or a 95% loan-to-value, the borrower has a high credit score or a lower one or if the mortgage is matched with another asset to hedge its risk. Likewise, there is no recognition of the risk differential among business loans if the business is a start-up or a mature business, if there is collateral and again if the loan-to-value is high or low.

Mortgage and business loan weights are totally concentration based, not credit risk or interest rate risk-based. This seems to be like over-insuring one's home for fire, but not for wind or theft. Effective risk management addresses all areas of risk.

The best way to measure whether a credit union is effectively managing the risk in a mortgage and/or business loan portfolio is to look at its historical performance – a figure available through the call report data being utilized by NCUA for this formula.

Any capital or net worth system that does not consider the historical performance of the financial institution in effective asset risk management is flawed and doomed to restrain the very growth in reserves it is designed to foster through increased earnings.

We would recommend that this proposal would be greatly strengthened by providing a credit of 50 basis points in every category of mortgage and business loan concentration if the credit union has had less than 1.5% charge offs in its business and/or mortgage loan portfolio as an average over the past three years.

Likewise, we are concerned that consumer loans have the same risk weight of .75% regardless of whether the loans are secured or unsecured. The 5300 Call Report data submitted by credit unions clearly delineate between secured auto loans, secured personal loans and unsecured personal loans and credit cards. Because of the obvious difference in risk associated with the secured versus unsecured consumer loans in every credit union's portfolio, we recommend that NCUA retain the .75% risk weight for unsecured non-delinquent consumer loans, lower to .25% risk weight the secured auto loans and lower to 0% those share secured loans backed fully by member deposits pledged to secure the loan.

EARNED BLANKET WAIVER AUTHORITY FOR CREDIT UNIONS WITH BOTH RATIOS IN THE WELL CAPITALIZED CATEGORY. For those credit unions with over 7% net worth under the statutory PCA rules and over 10.5% risk-based capital under the new rules, some earned authority and supervisory flexibility should be granted. We would recommend that, upon application by the credit union, blanket waiver authority should be granted for fixed assets beyond the 5% regulatory limit and for waiving personal guarantees on some business loans. In addition, we believe that the examination cycle for those well capitalized credit unions under both the statutory PCA net worth formula and the regulatory risk-based capital formula should be extended from twelve to eighteen months in order to enable the agency to focus its resources on those credit unions out of compliance with one or both of the two standards.

This would be a tremendous incentive for credit unions to keep both ratios and both standards in the green zone. After all, if a credit union board and management team can perform in excess of the required standards for both net worth and risk-based capital, they should be able to be trusted to make their own decisions about fixed assets and underwriting business loans.

A CAPITAL RESTORATION PLAN SHOULD BE THE SOLE DEFAULT REQUIREMENT FOR A CREDIT UNION BELOW 10.5% RISK-BASED CAPITAL BUT OVER 7% NET WORTH OF TOTAL ASSETS. If a credit union has over 7% net worth as a percentage of total assets, its failure to exceed the 10.5% threshold of risk-based capital should not trigger unnecessary corrective actions by the NCUA such as removal of officials or divestiture of assets.

The default requirement for a credit union with over 7% net worth but less than 10.5% risk-based capital should be submission of a capital restoration plan that would seek to bring the risk-based capital ratio into compliance with the 10.5% requirement within a reasonable period of time – normally thirty-six months.

CUSO INVESTMENTS SHOULD BE WEIGHTED AT 1.0%. NCUA enacted a new CUSO rule in 2013 that stated as its purpose the need to gather additional data on credit union CUSO investments because the agency did not feel comfortable it had a good handle on the amount of risk CUSOs bring to the credit union system.

Now it appears that, even though the agency admitted only months ago to having a lack of sufficient data to measure CUSO risk, the risk weight applied to CUSO investments in this proposed rule is the highest risk weighting applied to any asset at 2.5.

This figure seems artificially high to us and runs the risk of discouraging the risk sharing and cost saving collaborative model that CUSOs have become over the past several decades. The overwhelming majority of CUSOs are performing exceedingly well, generating considerable savings through economies of scale and providing much needed non-interest income to their credit union owners.

It is our understanding that the total CUSO investments of credit unions today stands at less than 22 basis points of credit union assets. We hardly see this as a systemic risk worthy of creating a chilling effect on CUSO investment and – through that lack of investment – a restriction on what has become a major credit union earnings driver and collaborative savings source.

It is our belief that credit union examiners can already gain the data they need from the credit unions that own CUSOs. From this data and working through the credit unions they supervise, the regulators can ensure CUSO return on investment is proportionate to the risk through the examination and supervisory process. A punitive risk weighting that is not commensurate to the actual risk is simply not appropriate and could have serious unintended consequences of driving many credit unions to sources outside the system where there is even less supervisory control through the credit union owners.

We would recommend that the risk weight of CUSO investments should be set at 1.0. Any exceptions to the historically strong performance of CUSOs can be managed, not through an unjustifiable arbitrary risk weighting, but instead through the credit union examination and supervision process on a case-by-case basis.

MORTGAGE SERVICING RIGHTS SHOULD BE WEIGHTED AT 1.25. While we recognize that there is some additional risk for credit unions in the area of mortgage servicing rights, it is our belief that the proposed risk weighting of 2.50 is disproportionate to the risk. We believe that a more appropriate risk weight would be 1.25 or, if the agency believes a higher weight is required, that weight should not exceed 1.50 and a performance- based credit determined by an average of losses resulting from mortgage servicing over the past five years (as discussed in our earlier recommendation on mortgage portfolio risk management) should be put in place.

PAID-IN CAPITAL TO A CORPORATE CREDIT UNION SHOULD BE WEIGHTED AT 1.0. The corporate credit unions have had more regulatory changes over the past five years than any other sector of the credit union system. Additional capital requirements. Stricter investment limits. More concentration risk prohibitions. Governance changes. A much larger examination department with expanded authority to take corrective action.

It is certainly hoped that these regulatory changes have made the corporate credit unions less risky for credit union investment. Most would agree that they have been largely successful to date.

With those rules in place, we cannot see a justification to count paid-in capital investment in a corporate credit union (a source of capital building that NCUA has encouraged and counted upon to strengthen the corporates following the recent crisis and through the new rules) at twice as risky as a dollar's investment in a mortgage loan in excess of 35% of assets.

Paid-in capital, in our view, would be more appropriately weighted at 1.00 or perhaps – if NCUA feels that more time is required before they are comfortable about potential corporate losses in the future - as high as 1.25. This would provide a proper recognition of the fact that the corporate credit union structure has gone through a total overhaul with new regulatory requirements. These new regulatory requirements have paid-in capital as a major component to protect credit unions and the share insurance fund.

WELL CAPITALIZED TRIGGER SHOULD BE 9% OF RISK BASED ASSETS. It is our belief that NCUA has gone well beyond comparability with other financial service industry capital requirements by proposing a 350 basis point additional reserve requirement through this regulation. The 7% net worth requirement already established in federal statute is calculated as a percentage of total assets and therefore currently requires a higher reserve requirement than any other sector of the financial services industry.

NCUA will essentially be utilizing this extremely high 7% of total assets net worth requirement as a leverage ratio in addition to the risk-based capital requirements proposed to be established in this regulation. With that high net worth requirement as a leverage ratio, we see no justification for an additional 350 basis points to be required for reserves under the risk-based capital formula. We believe and would recommend that 200 basis points would be sufficient and, in fact, still leave credit unions with higher capital requirements than any of type of financial institution – despite the conservative nature of credit union balance sheets as required by law.

We would support a trigger under the risk-based capital rule at 9% of risk-weighted assets in order to be considered well-capitalized.

EFFECTIVE DATE OF FINAL RULE IMPLEMENTATION SHOULD BE THREE YEARS FROM FINAL APPROVAL. There should be a three-year period allowed for credit unions to get ready for the implementation of such a far reaching set of capital standards that will require balance sheet management in every credit union in America.

Earnings needs will have to be balanced with the risk weighting of the assets necessary to build the earnings. Some investments will have to be shortened. Some loans will have to be divested – or at least the position in those loan categories adjusted.

Our experience working with credit unions indicates that, in our view, they will need a minimum of three full years to prepare for this regulation once it is finalized. A delayed effective date until a full three years after its final approval will be essential to making this rule truly effective

Again, we at the Louisiana Credit Union League support the concept of risk-based capital and appreciate the opportunity to comment on this important proposal. We encourage you to consider our recommended changes to the regulation which we feel could make it a better capital system that we and credit unions could much more reasonably embrace. Please do not hesitate to contact me if I or the Louisiana Credit Union League can be a source of assistance to you on this or any other matter.

Sincerely,

Anne M Cochran

Anne M Cochran
President/CEO

Cc: NCUA Chairman Debbie Matz
NCUA Board Member Rick Metsger
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