SEATTLE
METROPOLITAN
CREDIT UNION

MAY19'14 PM 2:04 BOARD

May 16, 2014

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

Re: Proposed Rule – Risk-Based Capital

Dear Mr. Poliquin:

Thank you for giving Seattle Metropolitan Credit Union (SMCU) the opportunity to submit comments on the above-referenced notice of proposed rulemaking. The proposed rule changes would revise the risk-weights for many of NCUA's current asset classifications; require higher minimum levels of capital for federally insured credit unions with concentrations of assets in real estate loans, member business loans (MBLs) or higher levels of delinquent loans; and set forth the process for NCUA to require an individual federally insured credit union to hold higher levels of risk-based capital to address unique supervisory concerns raised by NCUA."

SMCU supports the NCUA's efforts to address perceived weaknesses in the current capital framework and recognize the enormous challenges in developing a system that fairly and accurately reflect perceived risks across all affected institutions. We acknowledge the NCUA's attempt to keep the new requirements relatively simple and to minimize the implementation burden on affected institutions. These efforts, along with the extended time frame for implementation, will allow credit unions to adjust to the new ruling and restructure their balance sheets to ensure compliance.

The summary section of the proposal states that the NCUA set forth specific goals when developing the risk-based capital requirements under the proposed rule. Those goals are set forth as follows:

- "First, the [capital] requirement should address weaknesses in the net worth ratio measure.
- Second, the requirement should address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk.
- Third, the requirement should enhance the stability of the credit union system.
- Fourth, the rule should rely primarily on data already collected on the Call Report to minimize additional recordkeeping burdens.
- Fifth, the requirement should be, given the preceding four goals, as easy as possible to understand and implement."

While we agree with the desirability of the NCUA's intentions as outlined in the proposal, the proposed regulation does not meet the stated objectives. The comments provided below reflect the specific aspects of the proposal that, in our view, will have the most significant negative, and unintended, impact on the stability of credit unions, particularly SMCU. In addition, we have recommendations for modifications to the proposal.

We question whether a standardized capital ratio is an appropriate and effective measure to mitigate such a broad range of potential risks (second goal above). It appears that these new risk-weights are intended to regulate potential liquidity, market, and interest rate risk, in addition to credit risk. The NCUA proposal attempts to quantify risk exposure through expansion of risk-weight allocations by concentrations and weighted average life thresholds. These new risk-weights are substantially more punitive than the standardized risk-weight measures that are assigned to banks under Basel III. This may create incentives for institutions to reduce interest rate risk while substantially increasing credit risk. Those same risk weights also seem to ignore market liquidity factors applicable to investments, and provide inducements for institutions to purchase lower-yielding securities that could ultimately diminish earnings and capital accumulation over time. The proposed risk-weightings do not meet NCUA's objectives of improving existing capital guidelines and aligning with comparable bank guidelines. The risk weightings would lessen the ability of credit unions to compete within the financial institution industry.

The NCUA goals are keenly focused on controlling risks, but they are silent on the need for credit unions to meet member demands. Requiring higher levels of capital and reducing balance sheet risks; these requirements could also limit potential growth opportunities for individual credit unions and weaken the ability of credit unions to broadly serve member needs. The proposed risk based capital requirements would limit the capability of credit unions to appropriately support their constituencies.

Interest rate risk analysis and modeling should be performed separately from the risk based capital rules. This modeling is too complex to be handled adequately as part of risk based capital requirements. Asset and liability management policies and procedures are designed to address complex liquidity, concentration, interest rate and capital issues and are closely scrutinized during the examination process to ensure that the credit union is operating in a safe and sound manner. Efforts to control such a broad range of risks through too simplified a capital construct could actually increase risk and potentially limit the growth and operating capacity of the credit union industry as a whole.

The proposed capital regulations create an operationally constraining environment that could impair a credit union's ability to generate income and provide greater support to its capital base. With no current supplemental capital provisions, credit unions are entirely dependent upon earnings to support future growth and member service. The NCUA is missing an opportunity to address and approve supplemental capital provisions that could improve the stability and long term viability of the credit union model.

A primary purpose of capital standards is to protect the share insurance fund and minimize losses. The NCUSIF has performed well under the current capital rules, with far lower loss experience than that of the bank insurance fund. This performance was achieved during a period of financial stress not seen since the depression of the 1930s. It does not seem appropriate to require credit unions to raise additional capital at this time; after we very successfully weathered the recent economic storm under current requirements.

The deposit to the NCUA Insurance Fund is being subtracted from both numerator and denominator of the risk based capital ratio. This effectively assumes that the full amount will be expensed and used by NCUA, therefore a full hit to capital of every credit union. This treatment is inconsistent with current communications that the insurance fund is recovered from the current economic recession and that significant portions of this deposit will be refunded to credit unions in the future. Even though the timing of the refund is undetermined, there is still value in this balance. It should be left in the capital amount until it is determined to have been used and expensed. A maximum risk weighting of 100% would be appropriate. This change would have a significant positive impact on resulting risk based capital ratios.

The ability of NCUA to require a higher minimum capital requirement for an individual credit union based upon examiner judgment should be taken out of the proposal. The ambiguity and lack of transparency will not benefit the safety and soundness of the institution. The rules should provide a clear measurement methodology, removing differences of opinion as a factor of the capital rules. Adding an additional layer of potentially arbitrary constraints on top of the existing minimum capital guidelines could create confusion and inconsistency in the application of the standardized framework. This uncertainty would impact the ability of credit union boards and management to perform effective strategic planning.

In summary, we believe the proposal should be adjusted to become more aligned with the spirit Basel III model for evaluating and assigning risk-weights. While we understand that there are differences between the structure and operating capacity of credit unions and banks, we do not believe such dramatic differences between the capital frameworks for the two industries are justified. We believe the proposal's attempt to quantify and control a broad range of risks through a singular capital ratio is inherently flawed and could incentivize negative risk behaviors. We also believe that the deductions for the NCUSIF deposit and the reduced allocation for the ALLL should be revisited to ensure those proposals are consistent with the overall intent of the ruling. Similarly, we believe the "Individual Minimum Capital Requirement" provides a broad and undefined enforcement authority that is unnecessary given the revised capital framework and existing NCUA enforcement powers that already exist.

Seattle Metropolitan Credit Union is well capitalized under current NCUA requirements. Under the proposed requirements we continue to be well capitalized, but with diminished capacity to grow and serve member financial needs. The proposed capital requirements create a more challenging operating environment, reduce our competitiveness within the financial service industry and increases capital volatility without improving safety and soundness or the risk profile of the credit union.

If you have any questions or would like additional information, please do not hesitate to contact any of the undersigned executive officers.

Sincerely,

Richard Romero
Chief Executive Officer

Larry Grager
Chief Financial Officer