Educational
CREDIT UNION

May 23, 2014

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

RE: Comments on Prompt Corrective Action – Risk-Based Capital (RBC)

Dear Mr. Poliquin:

On behalf of the board and management of Educational Credit Union, we appreciate the opportunity to provide comments and information to the NCUA Board regarding the proposed revisions to the regulations that govern risk-based capital requirements for credit unions.

We as volunteer and management officials of Educational Credit Union believe in strong capital requirements for credit unions and, due to the cooperative structure of credit unions and our share insurance fund, we support NCUA's efforts to enforce strong capital requirements for the industry. However, we also believe that the current proposal needs significant changes to allow for the unique nature of credit union capital and net worth, and to avoid placing credit unions at a further competitive disadvantage with the banking industry. We fear that major restrictions as a result of new "one size fits all" capital requirements could seriously harm credit unions by restricting and/or altering the service they provide to member/owners.

Educational Credit Union (ECU) is approximately $190 million in total assets and located in Topeka, Kansas. ECU is also one of the 200 identified and much talked about credit unions that is directly impacted by the proposed regulation, as our December 31, 2013 data indicates we would fall from "well capitalized" to "adequately capitalized" if the regulation is implemented in its present form. In fact, our "well capitalized" cushion shrinks by $2.25 million, from a 101 basis point positive margin to a 21 basis point negative margin.

Our board and management believe our capital issue outlined above is not one of capital adequacy or current profitability; in fact our return on assets has exceeded our peer group in recent years. Instead, our lower ratio is largely the result of recent growth. ECU is currently experiencing strong member and asset growth trends, with total assets increasing an average of

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10% annually over the past five years. During that same period of time, our credit union has demonstrated our strength by transferring nearly $4 million into net worth, equal to a total return on equity of 36%. And this solid growth and financial performance has occurred during one of the worst economic periods experienced in our history.

As evidenced above, ECU's board and management believes growth is necessary and essential for the survival and success of all credit unions due to the need to gain economy of scale and be able to cover annually increasing operating expenses. The credit union capital mechanism of increases and maintenance through *only* net income retention is already stringent and limiting during periods of strong asset growth, and the new risk-based proposal makes it even more so when compared to options available for raising capital in the banking industry. We would also like to point out that banks will be considered "well capitalized" at a 10% risk based capital ratio (although with some potential operational restrictions), while credit unions must reach a risk based capital ratio of 10.5% to be "well capitalized" under the regulation.

In reference specifically to the proposed regulation, we believe the following concerns are the most critical and deserve the most study and modification prior to finalization of the regulation:

1. In general, the risk weightings assigned many of the loan and investment categories seem inordinately high, especially when compared to the Basel III requirements for banks. For instance, a comparison of asset categories indicates that the proposed regulation requires credit unions to weight 13 of 14 specific categories at a higher risk rating than banks. These 13 categories include the following:
    a. Securities – weighted up to *1000% higher* in credit unions than banks.
    b. First mortgage loans – weighted up to *200% higher* in credit unions than banks.
    c. Other mortgage loans – weighted up to *50% higher* in credit unions than banks.
    d. Business loans – weighted up to *100% higher* in credit unions than banks.

    The only exception within the 14 categories was credit union consumer loans, which were risk weighted just slightly lower than those in bank portfolios. This lower requirement for credit unions is likely justified, given the general lower rate of delinquency and charge-off in consumer loan portfolios compared to that of banks. But overall, our board and management question the more significant risk weightings placed on credit unions regarding the same or similar asset categories, even while credit unions are generally considered more conservative and recently weathered the economic recession by incurring losses at an overall level of approximately 10% of the loss ratio that was incurred at the FDIC during the same period. These risk weight differences coupled with the increased overall "well capitalized" standard mentioned above could ultimately lead to significant competitive disadvantages in the marketplace.

2. Several other risk weightings also seemed to be inappropriately high based on their individual characteristics, specifically including the following:
    a. CUSO investments – weighted at 250%, the highest rate within the proposal. ECU is currently an owner/investor in three multi-owned local CUSOs, all operational in nature. It is our belief that the risk weighting is too high for our CUSO investments, for reasons that include the following:

- the proposed risk weight requires capital to support 2.5 times the total funds invested in the CUSO, which in our case are Limited Liability Companies that basically limit potential loss to the total dollars invested;
- due to the nature of ECU's three CUSOs, the balance sheets are comprised of a total of 55% operating (vault) cash and 40% real estate or other small fixed assets, further substantially limiting any potential loss of the dollars invested; and,
- our CUSOs create an important return to our credit union based on the shared and efficient nature of member services conducted from them, whether or not they return a direct cash dividend to us.

It is our opinion that the proposed regulation should be modified to lower the 250% risk weighting, possibly by taking into account the unique nature and structure of the many CUSOs in the marketplace. As the unfortunate result of just a few prior abuses in CUSOs, this proposal seems to instead penalize a large group of CUSOs that have been very beneficial for credit unions overall.

b. Perpetual Contributed Capital – weighted at 200%.
ECU is a member of Kansas Corporate Credit Union (KCCU) and has Perpetual Contributed Capital invested in the corporate as a result of that membership. As a result of the new corporate credit union regulations adopted several years ago, the new business model adopted by our corporate, and our own ongoing monthly monitoring of their performance in meeting capital goals, the risk of future loss of this capital has been diminished greatly and yet the proposed regulation requires capital at a level of double our investment. Furthermore, a portion of this capital will no longer be "countable" in the calculation of capital ratios and of benefit to KCCU beginning in 2016 but would still be included at the elevated risk weight. This appears to penalize KCCU as well as ECU and other credit unions that choose to work cooperatively to receive critical financial services.

3. The potential exists for arbitrary and/or capricious over-reach in examiner authority in the "wild card" provision otherwise known as the Individual Minimum Capital Requirement (IMCR). This section of the proposed regulation allows for the application by NCUA of "subjective judgment grounded in agency expertise", even if a credit union meets both capital requirements established under regulation. This even greater increased capital requirement could be forced onto a credit union without any appeals process available except through NCUA's ombudsman. We believe this clause in the proposal is extremely broad and open-ended, and should be restricted or removed entirely.

4. The pending future completion of FASB's Current Expected Credit Loss (CECL) model for Allowance for Loan Loss and Lease calculations is likely to be released soon, and the resulting effect on credit union profitability and capital is another concern to ECU as it relates to this proposal. It is our understanding that this potential new requirement will involve the immediate projection of future losses instead of the current method utilizing recent history. Industry experts have estimated the CECL will approximately *double* the ALLL account over time, thereby affecting future profitability and capital levels for credit unions as a result. We would encourage NCUA to ensure that they take this type of future potential impact into account during finalization of the RBC proposal.

The proposed regulation will also likely override or ignore specific risk management and capital planning conducted by individual credit union board and management that takes many more factors into consideration beyond the more basic calculation formula using balance sheet risk weights discussed above. Credit unions that are performing extensive ALM modeling and similar testing will likely have a better understanding of the need for appropriate capital levels, and yet that type of detailed analysis can only be done by looking at the entire balance sheet and not just certain assets, as well as by doing so on an individual basis and not a seemingly "one size fits all" calculation formula.

As one final suggestion, it is our assertion that an extended deadline for implementation should be considered for this regulation. Credit unions will likely need to make significant changes to comply with the regulation, especially those like ours that potentially fall short of the "well capitalized" category. As mentioned above, credit unions can only accumulate net worth through retained net income and that cannot be accomplished overnight. Additionally, efforts that a credit union might make to adjust their balance sheet in order to meet the increased capital standard will also take considerable time. Therefore, we believe an extended compliance period for the regulation should be considered based on the significant changes it brings to the industry.

In summary, we believe that NCUA has put a great deal of detail into the proposal. But the current proposal is a potential major change to the current environment and could have significant negative impact on many credit unions and their members for years into the future. We believe that the proposed rule would be much improved if the concerns outlined above are addressed before any final change to the regulation is implemented. It is also our opinion that the regulation strays too far beyond credit risk and instead includes substantial components of interest rate risk and concentration risk – two additional factors that are already covered by NCUA under substantial rule and regulation requirements on credit unions.

Once again, the board and management of Educational Credit Union sincerely appreciate the opportunity to comment on the proposed regulation, primarily because we believe in strong but also fair capital requirements for credit unions due to the structure of the member/owner relationship and the cooperative nature of the industry.

Sincerely,

Jim Frownfelter

Jim Frownfelter
Board Chairman

Greg A. Winkler

Greg A. Winkler
President/CEO