



CREDIT UNION DEPARTMENT

Harold E. Feeney
Commissioner

Daniel J. Buckley
Deputy Commissioner

May 23, 2014

Sent electronically to: regcomments@ncua.gov

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

RE: Prompt Corrective Action—Risk Based Capital; RIN 3133-AD77

Dear Mr. Poliquin:

This is in response to the Notice of Proposed Rulemaking issued by the National Credit Union Administration (NCUA) requesting comments on the proposal to make various revisions, including replacing the agency's current risk-based capital requirements with new risk-based capital requirements for federally-insured "natural person" credit unions. In general, the proposed revisions would require higher minimum levels of risk-based capital for credit unions with concentrations of assets in real estate loans, member business loans, or high levels of delinquent loans.

The Department generally supports the efforts of the NCUA to modernize the existing regulation and construct a more sufficient regulatory capital system. We also appreciate the difficulties associated with the development of an ideal risk-based plan and acknowledge the work that has gone into developing the proposed structure. When credit unions fail by taking excessive risks without commensurate capital to back them up, federally insured credit unions pay for those losses through the National Credit Union Share Insurance Fund (NCUSIF). If the riskiest credit unions are required to choose between holding more capital or shedding risky assets in order to comply, then all other credit unions under this proposal face less of a future threat of special assessments and premiums. Nevertheless, the Department welcomes the chance to make constructive comments on certain aspects of the proposal.

In commenting on the proposed revisions, the Department wishes to emphasize to the NCUA the importance of state participation in the process of risk-based capital. Of particular concern are the discretionary actions that may be undertaken by the NCUA, including both the 1,250 percent risk-weight for certain asset backed investments (Part

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702.104) and the individual minimum capital requirement (Part 702.105). The Department urges the NCUA to continue the settled practice of coordinating supervisory actions with state supervisors. State supervisors' familiarity with their institutions and local conditions may exceed that of the NCUA and is a resource that should not be ignored. Consultation with state supervisors from the earliest stages of the process leading to a discretionary action offers the best opportunity to fashion an appropriate and effective response to problems. This is true no matter which authority under the Federal Credit Union Act the agency is acting under. The Department, therefore, requests the final regulation include more specific language as to the need and desirability for cooperation with the chartering authority from the very onset of any potential discretionary action.

Investments in CUSOs

While the Department understands and appreciates that there have been CUSO investment losses, NCUA's repeated and intense regulatory scrutiny of CUSOs is becoming counter-productive in that it will drive the activity into unregulated third-party service providers. As recently as November 2013, NCUA finalized a CUSO regulation that dramatically expanded NCUA's oversight of these entities. Purportedly that regulation addressed "material risks" that CUSOs posed by creating registry and reporting requirements focusing on "complex or high-risk" CUSOs. As a result, it was presumed that any significant risk that a credit union assumed from a CUSO investment would be transparent to NCUA; however, this proposal seeks to impose an additional, one-size fits all, 250 percent risk-weight on the cash investment in a CUSO. The Department does not believe that the excessively high 250 percent risk weight reflects a fair assessment of the actual risk held by most credit unions. Rather than treating all CUSOs like they are a great risk to each credit union, if NCUA believes that it has identified specific problem situation that poses significant risk, the agency should use its existing supervisory authorities to address the specific risky behavior. Therefore, the Department encourages NCUA to consider a bifurcated risk weighting structure for CUSOs that has no individual weighting greater 100 percent.

1,250 Percent Risk-Weight

The proposal gives NCUA broad discretion to require extra capital on asset-backed investments for which NCUA believes the credit union is unable to demonstrate a comprehensive understanding. While we agree with, and support the notion that such an investment could represent a safety and soundness concern, the Department is not convinced that this justifies calling upon additional regulations to do the work of quality supervision and the enforcement of existing regulations. The existing laws and

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regulations governing investments provide sufficient guidance and limitations. If a specific investment type is deemed inappropriate for credit unions collectively or individually, then current regulations and supervisory powers exist to limit or prohibit this type or class of investment. The arbitrary assignment of a risk weight based on a supervisory concern does little to deter the activity or remove the risk. It appears punitive in nature and will be based on opinions, not necessarily facts. Any revelation that a credit union may be making imprudent investments should be used by federal and state agencies as a trigger for increased supervisory scrutiny not rationale to promulgate more regulations. Section 206 of the Federal Credit Union Act confers upon NCUA considerable supervisory and enforcement authorities that can and should be utilized to mitigate this type of perceived risk to the National Credit Union Share Insurance Fund at individual credit unions.

At a minimum, the state supervisors' views are an important factor to be considered in connection with a 1,250 percent capital surcharge. Examinations of state credit unions are typically done jointly or independent of federal insurance reviews. The proposal does not specify at what level within NCUA this determination will be made, or whether NCUA would conduct an on-site review before making such a determination so it is possible that an independent state exam may, in fact, be the most recent evaluation. Through the establishment of excessive risk weighting factors, the NCUA could significantly reduce the value of a state charter, by effectively creating a competitive disadvantage for state chartered institutions operating within the confines of authorized state laws and rules. The Department urges NCUA to establish specific procedures for consultation with the states prior to imposing the capital surcharge on a state credit union.

Individual Minimum Capital Requirement (IMCR)

The Department believes NCUA already has the authority to reclassify a credit union into the next lower capital category under Prompt Corrective Action based on the existence of an unsafe or unsound condition or practice at a credit union. It is the Department's view that this existing authority already provides NCUA with sufficient tools to force additional capital retention under extraordinary circumstances.

The Department has serious reservations with the seemingly unrestrained circumstances that could justify the imposition of an IMCR. As currently drafted, this provision provides NCUA with complete discretion to demand higher capital levels from any credit union at any time. Although we are generally supportive of regulatory flexibility to handle varied circumstances, the Department suggests that such expansive discretion is unnecessary. For all practical purposes the NCUA is seeking unchecked authority to

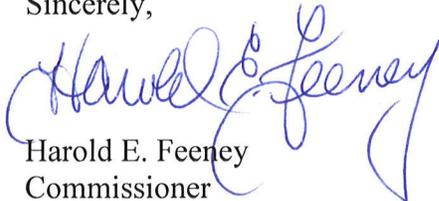
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subjectively establish capital requirements that could materially alter the natural dynamic tension between industry innovation and supervisory aspirations to maintain a safe and sound credit union system. Sufficient regulatory authority exists to protect the NCUSIF, the addition of IMCR is overreaching and absent clear standards, delineated administrative processes, transparency, and a legitimate appeals process, it should be removed from the final rule.

In addition, the Department wishes to accentuate the importance of coordination with state supervisors in connection with the imposition of a higher capital standard than the established regulatory threshold. The Department request the regulation include specific language as to the need and desirability for cooperation and coordination with state supervisors from the very onset of the process.

The Department hopes that these comments will assist NCUA in refining the proposed revision and appreciates the opportunity to comment on these issues.

Sincerely,



Harold E. Feeney
Commissioner

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