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May 27, 2014

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration ("NCUA" or "Administration")
1775 Duke Street
Alexandria, VA 22314-3428
regcomments@ncua.gov

RE: RIN: 3133-AD77 – Comments on Proposed Rule: PCA – Risk Based Capital

Mr. Poliquin:

Oregon Community Credit Union ("OCCU") joins a significant number of its peer institutions and advocacy voices in Oregon and across the country in expressing material concerns with the NCUA's proposed amendments to Part 702 of its regulations regarding prompt corrective action: Risk-Based Capital ("RBC rules" or "proposed amendments").

We respectfully request that the Administration consider the following recommendations as it moves forward to final rulemaking.

OCCU RECOMMENDS:

1. The proposed amendments should be carefully re-evaluated. The current net worth (or leverage) ratio requirement has served the industry well while allowing Credit Unions to manage their asset bases as they see fit subject to maintaining Member reserves at 7% or more of those assets. These Credit Unions are and will continue to be "Well Capitalized." The majority of banks, however, are required to meet just a 4% tier one capital (or leverage) ratio.

2. The Board of Directors ("board") and management of our Credit Union should be allowed to meet its unique Member needs in a safe and sound manner, as determined by the *current risk-based* examination process, and with regard principally to: (i) those Member needs, (ii) the currently required net worth ratio, and (iii) our demonstrated ability to assess and manage risks within our communities.

3. Absent the above recommended re-evaluation of the proposed amendments, the NCUA should consider:

    i. Removal of provisions allowing for broad examiner discretion in requiring capital levels greater than those established within the proposed amendments.

    ii. Addition of strong and independent Credit Union due process and remedial opportunities should the proposed broad examiner discretion section remain.

    iii. Delay of the effective date of any final rule, allowing for a 3-year or longer implementation period necessary for Credit Unions to cost effectively re-arrange their balance sheets to comply.

    iv. Reconsideration of the more restrictive factors of both the numerator and denominator in the proposed risk-based capital ratio equation.

    v. Reconsideration of all asset risk-weightings and a call for further industry analysis and input into *further rulemaking* regarding final establishment of these weights.

    vi. The existence of asset quality, demonstrated risk management activities, historical performance, and other qualitative and environmental factors in the calculation of risk-based capital regardless of weight-based outcomes.

    vii. Inclusion of risk-weight *ranges* for Credit Unions performing favorably with respect to the above performance factors as well as those designated as "Well Capitalized" under the current net worth ratio.

    viii. Reclassification of the risk-based capital table as a *model*, much like current IRR or liquidity risk management tools, as opposed to a "hard and fast" rule requiring rigid compliance thereto.

    ix. Exemptions to the proposed amendments or, alternatively, a capital "credit" for those Credit Unions historically concentrated and operating in business lines subject to significant additional capital requirements, such as MBLs, but where strong historical performance is demonstrated.

    x. Application of the more restrictive risk-based capital ratios *only* for Credit Unions below the "Well Capitalized" level.

xi. Additional rule changes allowing for Credit Unions to raise supplemental capital in order to meet the proposed risk-based capital thresholds and continue to experience growth and serve Members while complying with the thresholds.

DISCUSSION

Mr. Poliquin, OCCU offers the above recommendations following our careful review of the proposed amendments and their probable impact on our Credit Union and on our industry. Our review of the proposed amendments disclosed the following:

- ***The standardized, numerical requirements of the proposed amendments appear to have been established arbitrarily as opposed to premised upon (i) specific, risk-focused, industry-wide concerns with respect to capital allocations to each enumerated asset category and (ii) the realization that a "one-size-fits-all" solution cannot be applied universally to such a advantageously diverse population of Credit Unions***

- ***Adding to the uncertainty regarding the foundation and framework of the proposed amendments is a provision allowing the NCUA to require even higher capital ratios for individual Credit Unions demonstrating "circumstances" that allow examiners to require capital levels beyond the proposed framework.***

- ***While citing as a primary objective the desire to be consistent with "Other Federal Banking Regulatory Agencies" in proposing the amendments, the result is that Credit Unions would be competitively disadvantaged relative to banks.***

- ***The proposed amendments will have the unintended effect of weakening strong, well-managed Credit Unions and hurting the Members they serve.***

As with any significant proposed change within our industry, one uniquely grown directly from a cooperative-based mission of collective Member service and financial well-being, fundamental lines of inquiry should be weighed relative to the proposed change both industry-wide and at the individual Credit Union-level.

TO START - IS THERE A PROBLEM?

In considering the proposed amendments authored in response, presumably, to the Administration's concerns related to industry capital levels, we question the nature and severity of those concerns:

- It is readily accepted that the Credit Union industry neither caused nor was materially affected by the financial institution capital crisis triggered by the recent recession; a recession itself triggered by excessive real estate-based risk-taking by several of the nation's largest banks.
- The numbers are telling: from 2007 to the end of last year, the bank's FDIC insurance fund took roughly 9x the losses as the NCUSIF during the same period while almost 4x as many banks failed as Credit Unions during that same period.
- It is also a given that the banking industry alone suffered catastrophic capital losses from the capital crisis resulting in an almost unprecedented bail out of the industry by the federal government.

As a result, and in defense of the NCUA, the Administration has understandably sought to insulate itself from the perception that financial institutions *in general* may be undercapitalized and to take measures to ensure that its Credit Unions do not experience a similar fate should another economic crisis arise. However:

- In adopting a bank-oriented, corporate approach as its preventative capital crisis tool, the NCUA has proposed to address a problem from which Credit Unions have been insulated and, moreover, have demonstrated an ability to avoid.
- Compounding the concern associated with the need for such a preventative measure is the recommendation of a framework that clearly failed the banks during that industry's capital crisis; a risk-based capital framework in place since the early nineties and still today subject to refinement as part of the BASEL III accord.

NEXT - RIGHT FOR OUR COOPERATIVE MODEL; RIGHT FOR OUR MEMBERS?

In our view, and that of others through comments shared with you since the proposed amendments were announced, the RBC rules as currently contemplated literally threaten our cooperative model in favor of a long-instituted, yet clearly demonstrably unsuccessful, bank-originated corporate model:

- Bank capital preservation has at its core the maximization of shareholder value and optimization of return on invested, third-party equity, both of which represent important capital market forces and indicators of that market's health and sustainability.

- This model is wholly different than that of the cooperative model that seeks only to establish and preserve sufficient Member reserves for no other purpose than the betterment of those Members.

- The proposed amendments would serve to shift capital allocation and balance sheet management from each Credit Union's informed board and management to a template-driven regulatory structure rooted in a one-size-fits-all presumption without any consideration whatsoever for the Membership of that particular and unique Credit Union.

Along the way, this centralized, template approach, without consideration of the realities of the good work being performed every day at Credit Unions across the country, penalizes important contributors in our industry simply because these Credit Unions are viewed centrally in Virginia as higher risk:

- Credit Unions with missions to serve their Members in risk-controlled specialties such as real estate and small business lending, both clearly critical to regular Americans across the country, are penalized for and discouraged from doing so via these proposed amendments that place seemingly arbitrary constraints on those specific lines of business.

- In the smaller markets affected by this reality, and indeed even in larger markets, the result will unquestionably be a retraction in the provision of those services and detrimental reductions in vital services to those Memberships.

- The solution for these Credit Unions? Either raise more capital through earnings or reduce capital allocations to these services.

- However, unlike banks operating under a similar model and which can simply raise equity capital or issue debt-related securities to combat heightened capital requirements, Credit Unions must raise additional capital through earnings alone, those same earnings certainly to be reduced by required RBC rule-driven retraction of their core lines of business.

Permeating through this proposed one-size-fits-all, "off the shelf," template solution to risk management is the wholesale lack of recognition of the primary reason Credit Unions were spared the aforementioned capital crisis in the first place: a heightened sense of fiduciary responsibility to their Members coupled with sound risk and institutional management:

- Credit Unions do not play with equity in the form of "other people's money" and as such are more prone to act in the best interests of growing and preserving Member reserves.

- The proposed amendments make no allowances for the impact of strong and sustained risk management within Credit Unions currently and successfully managing what the NCUA deems in the proposed amendments as more risk-intense asset bases and balance sheets.

This approach, of course, is contrary to the entire notion of our *current* risk-based regulatory oversight and examination processes and their long-held recognition of relevant factors apart from static, numerical requirements when assessing Credit Union risk to capital:

- For example, all financial institutions designate credit risk as the most severe exposure to capital and all regulatory agencies and the accounting profession have promulgated, in response, not a rigid numerical template as contemplated here for capital risk, but a subjective-based approach to the assessment of credit risk.

- In fact, this already professionally subjective process has recently been exposed to yet additional subjectivity via the implementation of *qualitative and environmental* factors used to further measure the sufficiency of an allowance for credit losses.

- This begs the question; if the most risk-intense exposure Credit Unions face is mitigated through sound risk management and appropriate qualitative and environmental factors in addition to subjective loss rates based on *per institution* experience, why should capital at risk be wholly barred from that type of analysis and instead be measured against a one-size-fits-all numerical template applied universally to every institution?

- Furthermore, the proposed amendments then seek to limit the amount of the allowance available to cover asset erosion with a final consequence of nearly supplanting the entire risk-managed allowance provision process with a standardized formula.

FINALLY - WHAT DOES IT MEAN TO OCCU?

OCCU, like most Credit Unions, engages in annual strategic planning with its board in an effort to create short and long term objectives for our Membership. The key here is *our* Membership:

- For example, our current five year strategic plan, developed well prior to publication of the proposed amendments, includes expansion of our Member Business Services offerings, including MBLs. As we worked with our consultant partners and our board, and considered our internal competencies as well as Member benefits with respect to this line of business; we did not face an arbitrary potential risk-weighting of these assets.
- We simply asked ourselves "is this right for our Members opening small businesses and for our communities, and do we have the right resources to successfully deploy and manage capital at risk in this business?"
- The proposed amendments make this decision process superfluous, and instead require an overarching decision factor to now be whether desired growth in this business line would require additional capital *by formula*.

Likewise, we have made significant investments, along with several of our local community partners, in the formation of a CUSO offering credit and insurance products to the wider community:

- The proposed amendments would require us to reevaluate whether the returns from that venture can support the risk-weighting assigned to this equity investment in the CUSO over potential benefit to the Membership.
- In addition, we have contemplated other CUSO development opportunities, many in service-provision capacities to other Credit Unions, but would be required to offset any value-added considerations of these ventures with formulistic capital constraints on the entire asset class developed without any consideration of the relative risks of each prospective CUSO's mission or OCCU's demonstrated ability to manage those risks.

Thus, we sympathize with our peers:

- Who serve important regional interests such as those focusing on agricultural lending or single family residence lending as a material part of their balance sheets and who may face capital requirements under the proposed rule that could force them to exit or severely retract from these markets, thereby cutting off Members and their communities from indispensable services that oftentimes drive local economies and Member quality of life.

In the end, OCCU, like all impacted Credit Unions, will be forced to plan less strategically, with an eye toward its competencies and Member needs, and more regimentally with an eye instead toward the proposed RBC rules table.

OCCU'S OBSERVATIONS - THE PROPOSED AMENDMENTS

As stated above, our review of the proposed amendments indicates to us four fairly obvious categories of concern. Our review of submitted comment letters from our peers disclosed inclusion of even more areas of emphasis as they relate to their specific circumstances as well as many of the same issues we discuss below.

1. **The standardized, numerical requirements of the proposed amendments appear to have been established arbitrarily as opposed to premised upon specific risk-focused, industry-wide concerns with respect to capital allocations to each enumerated asset category. Below are examples of seemingly arbitrarily numerics and their probable results:**

    - A 250% risk-weight is assigned to investments in CUSOs with no regard to actual *per institutional* CUSO purpose (such as cost savings, or service CUSOs), profitability, or risk management activities.

    - Likewise, there is no recognition of actual performance, history, risk management, or expertise recognized in the proposed risk-weights assigned to MBLs – rather, only a % of asset application that would discourage small business and agricultural lending, for example, despite an individual Credit Union's demonstrated abilities to manage risk related to such portfolios.

    - The proposed risk-weighting of unfunded commitments with respect to MBLs only exacerbates the issue noted above.

    - Under the proposed amendments, certain longer term *federally-backed* securities are risk-weighted higher than loans as it appears that *interest rate* risk is considered more material in this scheme for investment assets than is credit risk.

    - In some cases under the proposed amendments, *secured* and *un*secured loans are assigned the *same* risk-weights.

- With respect to Credit Unions actively engaged in real estate mortgage lending, presumed risks in this activity are established via proposed risk weightings that do not take into consideration conservative loan to value lending practices (in fact, *asset quality*, a critical management pursuit, is entirely ignored) or even revised applicable regulations that have reduced credit risks in these books through aggressive regulation.
- Clear sources of capital in the form of unrealized gains on available for sale securities are specifically excluded from the definition of capital available to absorb asset losses.
- The NCUSIF deposit is specifically excluded from the definition of capital available to cover asset losses.

2. **Adding to the uncertainty regarding the foundation and framework of the proposed amendments is a provision allowing the NCUA to require *even higher* capital ratios for individual Credit Unions demonstrating "circumstances" that allow examiners to require capital levels beyond the proposed framework:**

   - The ability for the NCUA to, under a number of *vaguely defined criteria*, require individual Credit Unions to hold additional capital beyond the proposed requirements makes management to the proposed rule difficult and outcomes inconsistent between Credit Unions and examiners.
   - This enormous latitude in operating outside the proposed established framework and against which a Credit Union must measure and manage itself, in effect, allows for requirement of an uncapped capital ceiling based solely on examiner judgment and NCUA expertise, potentially resulting in a Credit Union passing both the net worth and risk-based capital ratio thresholds for a "Well Capitalized" institution but *still* required to acquire additional capital.
   - Results in board and management judgment being usurped by the judgment of field examiners.
   - The proposed amendments do not include any recourse or appeals process available to the Credit Union so that an independent determination that the higher capital requirement is warranted.

3. **While citing as a primary objective the desire to be consistent with "Other Federal Banking Regulatory Agencies" in proposing the amendments, the result is that Credit Unions would be competitively *disadvantaged* relative to banks:**

- In some cases, the proposed amendments include higher asset risk-weightings than required of banks resulting in Credit Unions tasked with having *higher capital* requirements relative to achieving the same capital ratio result.
- This places Credit Unions at a disadvantage relative to price-based competition, the precise and seminal argument made by the same banks against the cooperative model for nearly a hundred years.
- While banks have had multiple years to develop, consider, revise, and revise again their intended capital ratio scheme in BASEL III, the proposed amendments allow Credit Unions only eighteen (18) months to comply, meaning potentially drastic balance sheet changes at costs likely not advantageous to Members, the result of which could actually be wholesale *decreases* in industry capital.

4. **The proposed amendments will have the unintended effect of *weakening* Credit Unions and hurting the Members they serve:**

- Unlike banks, Credit Unions have no access to capital stock and must fund increased capital requirements entirely through earnings.
- Competing against this required earnings-based capital growth in the proposed amendments is a simultaneous discouragement of earnings-generating, risk-taking activities.
- The proposed amendments would further discourage Credit Union growth as emphasis is shifted to balance sheet conservatism and resulting risk-based capital ratio management versus growth and risk/reward considerations and Member needs.
- Elimination of mortgage servicing rights from assets in the proposed calculation could discourage interest rate risk-reducing/liquidity generating loan sale strategies, negatively impacting and discouraging loan participations between Credit Unions, resulting in Member service reduction.
- Additional capital requirements will naturally result in increased costs and decreased dividends to members as Credit Unions seek to preserve additional capital against the proposed risk-weighting of assets.

Mr. Poliquin, we appreciate the opportunity to be heard on this matter critical to our industry. We hope you will take our recommendations and discussion/observations in the spirit in which they are offered; constructive and with an eye toward the long term viability of our important industry. We also sincerely appreciate the NCUA's efforts these proposed amendments represent, an honest and diligent effort in reaching that very same goal.

Sincerely,

Mandy Jones

Mandy Jones
Chief Executive Officer
Oregon Community Credit Union