Whitefish
CREDIT UNION
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May 28, 2014

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

Re: Comments on Risk Based Capital Proposal

Dear Mr. Poliquin:

This letter is being submitted in response to proposed changes to NCUA regulations regarding Risk-Based Capital requirements (Prompt Correction Action – Risk Based Capital). Whitefish Credit Union (WCU) serves over 58,000 members in Northwest Montana. We have over $1.23 billion in total assets and a net worth ratio of 11.08% making us the largest credit union in the State of Montana.

WCU commends the NCUA in its efforts to modernize the credit union capital standards through the introduction of risk based concepts that have been more consistently applied by the FDIC, Federal Reserve, and OCC, as well as by financial institution regulators internationally. We believe that, at its core, the NCUA's primary objective should be to establish a uniform risk weighting system that better positions credit unions to absorb losses should serious risk events materialize.

As currently drafted, however, we fear that the proposed risk-based capital rules not only fall well short of meeting that objective, but also go well beyond what would be reasonable and prudent given the historical performance of credit unions in any number of historical risk events, including the most recent event which spanned the years 2007 to 2011. Furthermore, we fear that the proposed rules could very well have several unintended consequences, not only on the credit union industry as a whole, but on the members and communities they serve.

Risk Profile of a Credit Union

Variances in the performance measures between credit unions and banks serve to highlight just some of the clear and distinct differences between their business models. Credit unions have consistently operated with lower net interest margins, higher cost of funds, lower fee income, and lower operating expense. When we net out these differences, it comes as no surprise that credit unions consistently operate with a lower return on assets (ROA) than their banking counterparts (i.e., .50% to .75% for credit unions vs. .90% to 1.20% for banks).

In order to generate the net income necessary to support continued growth, ROA levels have likely hit bottom and arguably need to increase substantially. In order to increase ROA's, however, we must either increase net income or decrease capital levels. Since the proposed rules will add considerable capital burdens on nearly all credit unions (i.e., assuming that all credit unions will continue to operate with approximately the same capital cushions), net incomes will need to increase. Therefore, the higher capital requirements under the proposal will necessarily require credit unions to make significant and perhaps radical modifications to their business models, most likely on the revenue side of the equation. So it only makes sense that before we march down this path, we ask whether or not higher capital requirements are even necessary.

Compared to their banking counterparts, credit unions have traditionally been conservative lenders. Between 2007 and 2013, for example, net loan losses for credit unions averaged only 90bp compared to 162bp for banks. There have also been fewer credit unions failures. Between 2008 and 2013, there were only 136 credit union failures compared to 489 bank failures. As a matter of fact, between 1990 and 2013, total insurance fund losses per $1,000 of insured shares averaged only $.18 for credit unions compared to a much higher $.93 for banks. Finally, between 1988 and 2013, a time frame that covers two significant risk events, the NCUSIF funds have never fallen below $1.23 per $100 in insured deposits nor exceeded $1.31, a rather narrow fluctuation by any definition.

We highlight these observations because they appear to support the proposition that higher capital requirements may be unnecessary and perhaps the focus should be limited to modernizing the credit union capital standards to provide consistency with capital standards endorsed for other financial institutions under the Basel III Accord.

We believe that the objective of the NCUA should not be to "bullet proof" credit unions from the possibility of failure. We also believe that history supports the contention that current capital levels across the industry are reasonable at current levels. A review of historical trends might also suggest that perhaps the NCUA has become just a bit risk adverse given the rather narrow fluctuations in the insurance fund reserves during even the severe economic recessions.

<u>General Comments on the Proposal</u>

Risk-based capital rules under Basel III and employed by financial institutions around the world generally determine risk weights based upon the level of credit exposure assumed across a broad range of asset classes. We believe the proposed risk-based capital measures go too far by attempting to include an interest rate risk component and a concentration risk component.

We are also concerned that the risk ratings appear to be arbitrary and capricious and believe that the NCUA should be held to the same standard of support as the credit unions they supervise when establishing limits and benchmarks. By way of example, proposed concentration risk elevators for member business loans suggest that institutions with a concentration equal to 25% of total assets carries a 50% higher risk that institutions with only a 15% concentration yet institutions with a 50% concentration carry no more risk than an institution with only a 25% concentration. This directly contradicts empirical evidence covering the period 1997 through 2013 which suggests that higher concentration levels result in lower loss rates.

The proposed methodology and risk rating also implies that interest rate risk poses a greater risk to capital than asset quality. For example, a ten year government agency debenture will be risk rated at 200% under the proposed guidelines whereas a delinquent first lien mortgage loans and other delinquent unsecured loans will be risk rated at only 100% and 150%, respectively. This treatment is particularly punitive for institutions such as WCU who specializes in secured mortgage lending and who maintains a sizable investment portfolio of bonds issued by government sponsored entities. We find it quite troubling that the NCUA appears to give little to no consideration to the full faith and credit guarantee of the U.S. Government and gives little consideration for the implied guarantee of the U.S. Government for bonds issued by government sponsored entities. We find the latter particularly troublesome given that the implied guarantee was successfully tested during the most recent economic downturn. We believe there is considerable merit to a risk rating methodology that is consistent with that put forth under the Basel Accord.

<u>Other Concerns</u>

- The proposal would authorize the NCUA to impose even higher risk-based capital requirements on credit unions than the proposed10.5% required to be well capitalized. While we don't disagree that the NCUA needs this latitude, we do find it particularly worrisome that there are no strict guidelines for doing so, guidelines that could prevent the NCUA or its examiners from arbitrarily setting higher capital levels. At a minimum, we believe that the NCUA should be held to the same standard of support expected from the credit unions they supervise before they can impose such increases.

- We believe that assets with similar characteristics share the same risks regardless of whether those assets are held by a credit union, a bank, or any other financial institution. Accordingly, we find it troubling that the NCUA appears to find little if any merit in the standards established under the Basel III Accord. We also find it troubling that the NCUA would attempt to address interest rate risk within the proposed risk-based capital methodology, particularly when interest rate risk has already been adequately addressed under other NCUA regulations.

- Risk-based capital calculated under the Basel III Accord results in considerably higher capital than under the proposed framework. Given our limited access to the capital markets, this will put credit unions at a considerable disadvantage compared to banks and other financial institutions since our ability to absorb losses is limited by our ability to generate new capital through increased earnings. And because more earnings will be needed to support increased capital requirements, the proposal will have the unintended consequence of significantly reducing earnings available to execute current long-term strategies designed to achieve a higher core earnings base and grow at a pace that is necessary to effectively serve and support our member's needs.

Closing Comments

WCU supports the NCUA in its efforts to address weaknesses in the current capital management framework. We believe that, with modifications that are based on objective criteria, the new rules can bring considerable value to the credit union industry as well as the communities and members we serve.

We thank you for the opportunity to comment on the proposal and share ideas for improvements. We will look forward with great interest to future revisions.

Respectfully submitted,

WHITEFISH CREDIT UNION

By: Michael T. Blubaugh
Senior Vice President &
Chief Financial Officer