EASTMAN CREDIT UNION

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May 28, 2014

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

Re: RIN: 3133-AD77

Dear Mr. Poliquin:

Eastman Credit Union (ECU) is a federally insured Tennessee state chartered credit union and serves over 146,000 members. ECU is commenting on the NCUA's proposed amendments to the Prompt Corrective Action – Risk-Based Capital (RBC) requirements.

I. Introduction

As a financial cooperative, ECU's mission is to enhance member financial well-being while maintaining reasonable levels of financial strength. Risks inherent in providing varied and complex financial products requires prudent risk management conducted by experienced and qualified financial professionals. ECU recognizes that NCUA must take measures necessary to ensure that credit unions maintain appropriate levels of net worth to protect the integrity of the industry and the National Credit Union Share Insurance Fund (NCUSIF). Failure of credit unions or NCUA to act in a prudent manner can defeat the very reason for credit union existence.

Subsequent to our review of the proposed RBC rule, ECU has significant reservations, primarily for the following reasons:

a. **There is no evidence the proposed rule will enhance safety and soundness.**

   NCUA has failed to explain how the current risk-based net worth structure is insufficient to protect the NCUSIF and how the proposed risk-based capital structure is better equipped to do so **(see part II).**

b. **The proposed rule vests examiners with excessive authority to alter credit union policy.**

   The proposed rule vests significant and relatively unfettered authority in NCUA examiners to substitute their judgment for that of credit union management and boards, regardless of the demonstrated expertise of management or the performance of the credit union **(see part III).**

c. **The rule is fundamentally flawed.**

   The proposed rule fails to address inherent material risks that could result in negative and unintended consequences **(see part IV).**

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d. <u>The risk weightings appear to be arbitrary.</u>

The rule fails to adequately explain how NCUA arrived at the assigned risk weightings **(see part V).**

II. Why is this Risk Based Capital Rule Necessary?

In discussing the proposal, NCUA states that it's analysis of the 2013 Call Report data indicates that the overwhelming majority of credit unions with over $50 million in assets already have sufficient capital to comply with the proposed risk-based capital rules. Based upon this analysis, ECU questions whether the proposed risk-based capital structure is necessary. The current risk-based net worth structure results in more than sufficient capitalization for those credit unions posing the greatest risk to the NCUSIF. ECU is unconvinced that this proposal will place credit unions in a better position to mitigate risk and address safety and soundness concerns.

If adopted as proposed, credit unions will be faced with the compliance burden of increased costs associated with updating policies, data collection, and updating reporting systems. It is fundamentally unfair to require credit unions to incur this substantial burden without providing an explanation of how this rule will improve the safety and soundness of credit unions. ECU urges the NCUA to explain why this rule is necessary and how it is superior to the simple leverage ratio currently in place before requiring the substantial and disruptive investment in time and cost that implementing it will incur.

III. Individual Minimum Capital Requirements (IMCR) Should be Eliminated.

The proposal includes a provision that NCUA may require a higher minimum risk-based capital ratio for an individual credit union in a broad range of circumstances where the examiner determines that a higher IMCR is appropriate. Therefore, examiners across the country have substantial discretion and may require a credit union that has diligently structured its capital levels to restructure its entire portfolio strategy because of the subjective judgment of the examiner. And, as the proposal provides no appeal process for the credit union, the credit union effectively has no recourse if the examiner has made an incorrect assessment.

ECU is concerned that the subjective nature of the rule as written will lead to unfair and inconsistent examiner interpretation and application. As proposed, examiners are afforded almost unfettered discretion in determining a credit union's appropriate capital level. Even if a credit union meets all other requirements under the proposal, it may still be required to increase its capital level based on the judgment of one examiner. The proposed rule contains within it the inherent assumption that the examiners will uniformly exercise superior judgment and possess greater expertise than credit union management. That is simply not reasonable or possible. The authority granted by the rule to NCUA examiners to override the expertise and judgment of credit union management and boards is unreasonable and dangerous.

ECU strongly urges NCUA to remove the IMCR provision from the proposal. However, if NCUA insists on retaining the provision, there must be a process to ensure the decision to require an IMCR is made at a high level of the agency and only after a rigorous review process coupled with a meaningful appeal mechanism.

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IV. The Proposed Rule Will Not Produce the Desired Results.

One of the objectives of the proposed rule is to "include all material risks" to ensure that each credit union has the capital necessary to support its individual risk profile and strategy. The rule focuses on interest rate risk, concentration risk, credit risk, market risk, and liquidity risk. However, the proposed rule fails to adequately address those identified risks, and ignores other risks all together, such as the risks presented by liability management.

a. An example of the inadequacy of the proposed risk weightings is found in the zero risk weighting of Treasuries and NCUA Guaranteed Notes (NGNs). The impact of rapidly increasing interest rates on the value of Treasuries and NGNs is ignored in the risk weighting under the rule. A credit union that chose to mitigate its risk by carrying large amounts of Treasuries and NGNs could incur significant losses if it had to sell those assets in a rising interest rate environment – yet those assets are categorized as having zero risk.

b. The rule's options for risk weighting of asset-backed investments (such as mortgage backed securities (MBS)) are also troubling and demonstrate the inadequacy of the proposal in capturing material risks. The proposal provides for risk weighting based on the instrument's weighted average life. However, the average life on amortizing securities can change dramatically depending on the movement of interest rates. Any static measure of risk that does not include potential movements in rates can lead to serious unintended consequences.

c. Under the proposed rule, a credit union that cannot demonstrate "a comprehensive understanding of the features of the asset-backed investment" will be required to assign a 1250% risk weighting. This provision suffers from the same defect as the provision for assigning IMCR discussed above. What is required to demonstrate a "comprehensive understanding?" What is a credit union's recourse if its examiner decides the credit union has failed to meet that requirement? If a credit union is required by its examiner to revise its risk weighting from 75% (for example) to 1250% for a group of assets, that requirement could wreak havoc on the credit union's overall asset strategy.

d. The rule also does not address the importance of a credit union's management of its liabilities and the relationship between the cost of funds and management of interest rate risk. The goal of managing liquidity risk cannot be met if liability management is not a component. However, the addition of an arbitrary risk-weighting for a credit union's deposits is not a cure of this defect in the rule. Management of liabilities is complex and simply adding deposits to the risk-weighting matrix would be imprudent and potentially disastrous.

V. Risk Weightings and Consistency with Banks

NCUA states that it intends to make the credit union risk-based capital structure more consistent with the measures used by the banking industry. Basel III is focused on credit risk. However, NCUA's RBC proposal covers not only credit risk, but also interest rate, concentration, liquidity,

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operational, and market risk. Furthermore, NCUA's proposal weighs the following areas significantly higher than Basel III: government guaranteed residential mortgages, non-delinquent first mortgage loans, other real estate loans, and MBLs.

NCUA has not adequately explained why its RBC proposal is significantly broader and more burdensome than Basel III. Based on the proposed risk weights, credit unions may be forced to limit activities in business lending and residential mortgages, thereby putting credit unions at a disadvantage. Due to the lack of justification in the proposal, the risk weights appear to be unsupported and arbitrary. If NCUA determines it must implement a risk based weighting system, the risk-weightings should be re-evaluated to more accurately and fairly reflect the risk to credit unions.

VI. Conclusion

ECU has raised the concerns in this letter to demonstrate that this proposal does not accomplish the NCUA Board's goal to create a rule to protect the industry and the NCUSIF. The proposed rule can and will create unintended and significantly negative consequences for credit unions. No amount of rule-making can substitute for prudent risk management and analysis. Despite the NCUA Board's efforts, the rule as outlined will hamstring and punish well-run credit unions while failing to identify material risks. The ultimate outcome will be negative for credit unions and their members. We strongly urge the NCUA Board to reconsider and withdraw its proposed Risk-Based Capital Regulation.

Sincerely,

Olan O. Jones, Jr.

Olan O. Jones, Jr.
CEO and President
Eastman Credit Union