SAFE
CREDIT UNION

April 17, 2015

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

Re: Proposed Risk-Based Capital Rule (RIN 3133-AD77)

Dear Mr. Poliquin,

Thank you again for the opportunity to comment on the NCUA's recently revised Proposed Risk-Based Capital Rule. We have reviewed the revised rule and have developed a list of comments for your consideration. As mentioned in our letter last year, SAFE is in favor of implementing a risk-based capital structure for credit unions. We agree with the concept of implementing an approach that effectively quantifies the risk associated with each type of an institution's assets and ultimately produces a risk-adjusted capital ratio. The following comments reflect our current questions, concerns, and overall feedback about the proposed rule and the impact to credit unions if adopted in its current form.

A. General Comments

1. **Definition of Complex Credit Union** – In the revised rule, the proposed definition of what constitutes a "complex" credit union has been modified to include those credit unions that exceed $100 million in assets. We still believe this is a subjective approach to identify which institutions carry more or less risk to the industry and insurance fund. The total amount of assets an institution manages should not be the only consideration for defining complexity. The type and quantity of products and services offered (such as business lending, credit cards, and indirect lending), membership growth, the presence of goodwill and intangible assets, the use of derivatives, borrowings, or the selling of mortgage loans should also be considerations of whether an institution is considered "complex." SAFE has seen first-hand examples of smaller institutions having more capital risk than larger institutions. Our experience has shown us that compliance requirements, inability to grow membership, a severe lack of internal controls, and desire to offer too many products and services (rather than fewer with a dedicated focus) has made it difficult to compete and mitigate capital risk. In addition, smaller credit unions have failed at a higher rate and have had a higher incidence of catastrophic failure due to a lack of comprehensive internal management and process controls that can lead to fraud. A credit union charter is a privilege and not a right. Asset size should not be the basis from which a credit union is included or exempt from risk-based capital rules. **We strongly recommend NCUA adopt a policy subjecting all credit unions to the same risk-based capital rules and the same examination standards.**

2. **Interest Rate Risk and Concentration Risk** – We applaud the NCUA's effort to remove/reduce some of the interest rate risk and concentration risk from the proposed rule. We still believe

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some of the risk weightings for specific products are too high. Please refer to Section B in this letter for additional commentary regarding specific product risk weighting concerns.

3. **Risk Weightings** – We appreciate and agree with NCUA's efforts to modify and reduce the majority of risk weightings and make them comparable to those issued by the FDIC. While we may not agree with all proposed weightings, we certainly believe this is a major step in the right direction. Please refer to Section B of this letter.

4. **Implementation Date of Proposed Rule** – We agree with the January 1, 2019 implementation date and ensuring the rule coincides with all required changes to the 5300 Call Report.

5. **Definition of Well-Capitalized Institution** – We agree with the proposal to lower the definition of a well-capitalized institution from 10.5% to 10% as it relates to risk-based capital.

6. **Allowance for Loan Losses** – We agree with NCUA's proposal to remove the cap on the inclusion of the allowance for loan losses in the numerator.

7. **Goodwill and Other Intangibles** – The current proposal indicates that goodwill would be deducted from both capital (numerator) and assets (denominator) in the risk-based capital ratio calculation, except for goodwill and other intangibles related to supervisory mergers. We do not agree with the NCUA's proposal for the treatment of goodwill and other intangibles on a number of levels. First, we don't believe goodwill and other intangibles should be deducted from either the numerator or denominator as this will discourage healthy credit union consolidation within the industry. Second, separating goodwill and other intangibles derived through a merger of healthy credit unions versus those assisted by a regulator does not make sense for the following reasons:

    a. Some mergers that involve troubled credit unions may have had informal assistance from state or federal regulators, but may not meet the definition outlined in the proposal as supervisory-assisted. This will create inconsistency in the application of the rule.

    b. Treating goodwill and other intangibles differently between supervisory-assisted, even on a grandfathered or limited time basis, is frankly inconsistent and provides potentially more risk to the insurance fund as the risk-based capital ratio may not reflect the actual risk of future impairment of these assets. In other words, the goodwill and other intangibles recorded as a result of a merger with a troubled credit union may be more at risk than that of a healthy merger but will not be reflected as such in the risk-based capital ratio.

    c. The proposed rule favors troubled credit union mergers while discouraging healthy credit union consolidation due to the negative impact on the risk-based capital ratio.

    d. Using a 10-year life for supervisory-assisted transactions provides only temporary relief for those credit unions impacted and it overstates the risk-based capital ratios until the phase-out period is over.

To summarize, we recommend eliminating the goodwill and other intangible reduction to both the numerator and denominator. If NCUA believes this is still necessary, we then recommend removing the exclusion for supervisory-assisted transactions along with the 10 year phase-out period.

B. Specific Risk-Weighting Concerns

1. Investments

a. **Publicly Traded Equity Investments (300%) and Non-publicly Traded Equity Investments (400%)** – While it is clear that an equity investment carries a first position, unsecured type risk of loss, the regulations do not explain why the risk of loss would be three or four times the actual equity investment itself. The proposed risk weightings assume the risk of loss on a $10,000 equity investment is $30,000 - $40,000 instead of $10,000. We recommend either reducing these weightings to 100% or providing a more thorough explanation why such investments warrant such an extreme weighting.

2. Commercial/Member Business Loans (MBLs)

a. While improvement was made in the proposed regulation, we believe there is still room for improvement for this asset category. The current proposal provides the following risk weightings for business/commercial loans:
   - < 50% of assets = 100%
   - > 50% of assets = 150%
   - Non-current = 150%

   We do not take issue with the proposed 100% weighting for this asset category. However, it appears NCUA is using concentration risk as the primary basis for increasing the weighting to 150% if commercial loans exceed 50% of assets. While this does not impact SAFE today nor do we expect it to in the future, we fail to understand the logic behind increasing the weighting simply because of the concentration of assets. Instead, the weighting should be based on the risk of loss (underwriting) rather than the concentration of the asset. If the underwriting is sound, then the risk should be mitigated. In addition, if it makes sense to assign the same risk weighting to a non-current commercial loan as it does to a current loan that happens to exceed 50% of assets, it would suggest there is no difference in credit risk. As such, we recommend eliminating the tiered approach and apply a 100% weighting to all commercial loans, including non-current commercial loans.

b. We do agree with the NCUA's proposal to treat 1-4 family non-owner occupied real estate loans as residential real estate loans rather than commercial loans. We further support the same reclassification of these loans out of the Member Business Lending section of the 5300 Call Report.

3. 1st Lien Residential Real Estate Loans and Junior Real Estate Loans

a. Our primary concern with these two types of asset classes is the same as described above for Commercial loans. Concentration risk is appears to be the basis for using a two-tiered system of assigning risk weightings to these asset types. The proposed rule would assign a 50% weighting for 1st lien real estate and a 100% weighting for junior real estate loans where the assets remain below 35% and 20%, respectively. We have no issue with the 50% and 100% weightings. The issue is that the weightings increase to 75% for 1st liens and 150% for junior liens once the concentration increases to 35% and to 20%, respectively.

   As explained in our previous comment letter, we strongly believe that concentration risk is again the wrong place for NCUA to gauge risk. We believe that a credit union that focuses on one or two types of lending and masters those types of lending inherently may be of lower risk than another credit union that originates mortgage loans, auto loans, indirect auto loans, business loans, credit card loans and student loans. Each type of lending has its own complexity and requires specialized knowledge. Yet a concentration biased-penalty drives credit unions to be a jack of all trades and potentially a master of none in order to avoid concentration risk. NCUA would be far better advised to consider how well a credit union manages risk through its underwriting and servicing policies. We would argue that specialization and mastery offset concentration risk. We would argue that the more types of lending a credit union manages, the level of assumed risk likely increases. The proposed risk weighting structure assumes a credit union that focuses on real estate loans, for example, with staff who are intimately versed in making those loans and have sound underwriting policies, carries more operational risk than a credit union that makes all types of loans but does only a handful of mortgage loans each month. The logic behind the tiered weighting structure does not appear to be based on documented history or fact-based data. We recommend that the NCUA remove the percentage of assets component and assign a weighting of 50% for all 1st lien residential real estate loans and 100% for junior lien real estate loans.

b. Additionally, we noted that the weighting for non-current junior real estate loans is 150%. Similar to previous comments, we do not believe a weighting above 100% is warranted simply because it is a junior lien. For a non-current 1st lien residential real estate, the proposed weighting is 100%, which we would agree with and is a reflection of the potential risk associated with the asset. We believe a non-current junior lien would have the same type of risk and recommend that the weighting be assigned the same 100% risk weighting.

4. Other Assets

a. **Unconsolidated Investments in CUSOs (150%)** – Similar to equity investments, it is not clear why an equity investment in a CUSO carries a weighting above 100%. Further, what is the basis for giving an equity investment in a CUSO (which is typically illiquid and unsecured) a significantly lower weighting than an equity stake in either a publicly or non-publicly traded investment as described above in item B.1.a. We recommend that the risk weighting for CUSO investments be capped at 100%.

The above areas comprise our major concerns with the latest proposed rule. We thank you for the opportunity to provide additional comments and feedback and look forward to your response.

Sincerely,

Chris Harris
SVP/CFO
SAFE Credit Union

cc: Henry Wirz, CEO
SAFE Credit Union