Allegacy
P.O. Box 26043
Winston-Salem, NC 27114-6043
AllegacyFCU.org

April 24, 2015

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

*Via email to:* regcomments@ncua.gov

Re: Comments on the Revised Proposed Amendment to Part 702 – Prompt Corrective Action

Dear Mr. Poliquin,

Thank you for the opportunity to be heard. Allegacy Federal Credit Union ("Allegacy") continues to appreciate the notice and comment process of the aforementioned proposed rulemaking. Allegacy recognizes the National Credit Union Administration's ("NCUA") efforts to modernize NCUA Regulation Part 702 – Prompt Corrective Action ("PCA") to reflect financial services industry changes to a risk-based capital ratio approach, comparable to Basel III. We agree that credit unions should hold capital commensurate with the risks they are taking in order to mitigate risk to the National Credit Union Share Insurance Fund.

Allegacy very much appreciates the revisions that were made from the original proposal, specifically the extension of the implementation date to January 1, 2019 and the recalibration of many of the risk weights. However, we still have a number of serious concerns regarding the revised proposal.

**Proposed Rule Violates the Federal Credit Union Act**

The NCUA does not have the legal authority to impose this regulation, because it does not have the authority to implement a two-tiered risk-based net worth system. Since 2000, the NCUA has been operating under the impression that it did not have the authority to institute a two-tiered risk-based net worth system. We find it quite telling that the NCUA solicited opinions from eleven law firms regarding the legality of this rule, and after shopping around paid Paul Hastings, LLC $150,000 to render an opinion on risk-based capital's legitimacy. The NCUA's change in position regarding a two-tiered risk-based net worth system could be viewed as an arbitrary change in position, and as such be susceptible to a *Chevron* challenge under the arbitrary and capricious standard. [1]

The Federal Credit Union Act ("FCA Act") requires the NCUA to develop a system of PCA that is comparable to PCA employed by the Other Federal Bank Regulatory Agencies, but that also takes into account the unique nature of credit unions. The FCU Act specifically identifies credits unions as not-for-profit financial cooperatives that "(i) do not issue common stock; (ii) must rely on retained earnings to

[1] *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

build net worth; and (iii) have boards of directors that consist primarily of volunteers."[2] One of the most unique characteristics of a credit union is that unlike its banking brethren, it cannot go into the market to raise capital. The proposed rule does not sufficiently take into account the unique nature of credit unions.

Administrative agencies are tasked with implementing legislation passed by democratically elected members of Congress. The FCU Act requires the NCUA to adopt a risk-based net worth plan – but the proposed rule establishes a two-tier system of risk-based capital standards and risk-based net worth standards. The NCUA has stepped outside its scope of authority by proposing a two-tiered system, replacing its judgment for that of Congress and credit union management.

Further, the FCU Act directs the NCUA to "design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection."[3] As such, the NCUA should only create a risk-based net worth system at the adequately capitalized level. If a credit union is over the adequately capitalized threshold of 8%, it should have no additional capital requirements. For example, if 8% is the risk-based capital requirement for adequately capitalized credit unions, no more than 8% should be the risk-based capital requirement for well-capitalized credit unions. Allegacy believes that the NCUA cannot impose additional capital requirements at the well-capitalized level, and recommends the NCUA tie any risk-based capital requirement to the adequately capitalized level, consistent with the FCU Act.

**Risk Weights**

Allegacy was very pleased to see that in the revised proposal, the NCUA lowered many of the risk weights from the original proposal. Unfortunately, we still believe that the risk weights for (1) credit union service organizations ("CUSOs") and (2) mortgage servicing assets are too high.

(1) While we acknowledge and appreciate the improvements in reducing the risk weighting on wholly owned CUSOs to 100%, we remain concerned with a 150% risk weighting on CUSOs that are owned by multiple credit unions. Allegacy has minority investments in three multi-owned CUSOs totaling approximately $575,000. Additionally, Allegacy wholly owns one CUSO, Allegacy Services, LLC. Allegacy Services, LLC wholly owns three subsidiary CUSOs, and has minority investments in four multi-owned CUSOs totaling approximately $2 million.

CUSOs act as a hedge for interest rate risk. They provide a diversified income stream, serving as a supplemental form of income that is non-interest income. That supplemental income helps the credit union to build capital, and actually reduces risk to the insurance fund. Generally, such a diversified portfolio is a prudent strategy.

By penalizing credit unions involved with multi-owned CUSOs, this will stifle innovation and reduce competition – two extremely harmful effects. CUSOs act as a structure to promote industry efficiency, pooling expertise to better serve credit unions. They complement the cooperative spirit of the credit union movement. They provide targeted credit union support companies, and without them competition with other financial services support companies will be reduced. This will hurt small credit unions with regard to pricing and customer service with third party vendors, who may not be interested in small accounts, or do not understand the unique nature of credit unions. Allegacy recommends the NCUA make the risk weight 100% for all CUSOs.

(2) The risk weight for mortgage servicing assets remained the same from the original to the revised proposal, at 250%. Allegacy does not agree with this risk weight.

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[2] 12 U.S.C. § 1790d(b)(1)(B).

[3] 12 U.S.C. § 1790d(d)(2).

The NCUA has made it clear that it wants credit unions to carefully manage interest rate risk ("IRR"). For most credit unions, that means that there is limited capacity on their balance sheets to hold 30-year fixed rate assets. To comply with the NCUA's mandate on managing IRR, most credit unions need to sell most of their 30-year fixed rate mortgage originations to third parties like Fannie Mae or Freddie Mac.

Mortgage loans are the most significant member relationship the credit union has. Allegacy reduces IRR on our balance sheet by selling a mortgage, but then retains the servicing rights for a better member experience. Our members generally prefer the credit union to service the mortgages they obtained from us. They want to deal directly with Allegacy, not another company. Many members get very angry when they find out their mortgage has been sold with servicing rights released. As a result, we sell most of our mortgages with servicing rights retained.

The 250% risk weight is effectively a penalty for holding mortgage servicing assets, and will force the credit union to consider selling them, even though this is against the desire of our members. In the long run, such a decision could reduce the credit union's mortgage volume, which would be very detrimental. Allegacy recommends the NCUA reduce the risk weight for mortgage servicing assets comparable to other mortgage related risk weights.

**Goodwill and Intangibles**

Goodwill was excluded from the risk-based capital ratio formula in both the original and revised proposal – Allegacy disagrees with this and does not believe goodwill should be deducted from risk-based capital ratio. The only change regarding goodwill is that credit unions with outstanding goodwill or intangibles recorded from supervisory mergers or combinations completed prior to publication of a final rule will be allowed to include the related goodwill and intangibles until January 1, 2025. Other forms of goodwill remained excluded. If the credit union were to seek out its own merger, it cannot count goodwill. Businesses grow and combine to achieve economies of scale, and this discourages credit unions from growing because they will need to retain additional capital to maintain a targeted risk-based capital ratio. Allegacy contends that NCUA's treatment of goodwill will affect our strategic business decisions because of its unfavorable treatment of goodwill.

**Interest Rate Risk**

Allegacy acknowledges and appreciates that NCUA removed IRR from the revised proposal. NCUA has indicated that it will deal with IRR separately. As such, the concern remains how the NCUA will deal with this issue, and the potential impact of increased regulatory burden.

Allegacy agrees that IRR should be proactively measured and managed, but contends that it is already heavily regulated and examined. NCUA has in place a very complete and up-to-date protocol for guiding and supervising both net interest income ("NII") and net economic value ("NEV"), which serves to protect the share insurance fund. Current IRR regulations incorporate years of research and experience by both regulators and practitioners, and recognize the entity-specific complexities of measuring, modeling, managing, and controlling IRR.

Allegacy strongly believes that IRR is already adequately regulated and examined, and is concerned any additional proposals or requirements from the NCUA will be an unnecessary duplication and compounding of regulation, increasing the time required by management and examiners to monitor and assess compliance. We recommend there are no new IRR proposals.

**Supplemental Capital**

Under the FCU Act, credit unions must rely only on retained earnings to build net worth and are not permitted the use of supplemental capital. Historically, this has served credit unions well, but in the ever changing and increasingly competitive financial services marketplace, it limits the ability of healthy credit unions to grow. Allegacy supports the introduction of supplemental capital and looks forward to a proposal from the NCUA.

**Capital Adequacy**

The revised proposal eliminated the provision requiring individual minimum capital requirements imposed by an examiner on a case-by-case basis. Allegacy appreciates this as it was clearly overbroad and not provided for in the FCU Act.

The revised rule adds a requirement that a "complex" credit union maintains capital commensurate with the level and nature of all its risks, and has a process to determine its capital adequacy in light of its risk, as well as develop a comprehensive written strategy to maintain an appropriate level of capital. This would still allow for too much discretion in the field and create serious uncertainty by potentially subjecting credit unions to higher capital requirements than what are specifically required by the risk-based capital regulation.

Allegacy is very concerned with this addition, as we believe that strategic capital planning should not be the subject of examination and supervision, but rather a business decision of the Board of Directors and management. We strongly believe that adequate capital commensurate with risk is the responsibility of each individual credit union – and should not be left to the judgment and discretion of examiners. This would simply be another way for the NCUA to use "safety and soundness" as an excuse for overstepping their boundaries and getting too involved in credit union business decisions. Allegacy recommends that this addition be removed from the revised proposal.

**Increased Complexity of Preparing 5300 Call Report**

The revised proposal will require extensive changes and additional data fields be added to the call report. In light of the time allowed to complete the call report, Allegacy is very concerned about these additional data fields, the subsequent risk of late filing, and the threat of civil money penalties.

Currently, call report and profile submissions are due the fourth Friday of each month following the end of a quarter, whereas banks have until the $30^{th}$ day of each month following the end of a quarter. Because of the NCUA's timing deadline, this can reduce the amount of time to complete the increasingly complex call report. For example in the 2015 calendar year, every quarter credit unions will effectively have only three weeks to complete the call report.

Due to the complexity of preparing the call report, and the extensive changes and additional data fields that the risk-based capital proposal will require, Allegacy recommends that the NCUA change the filing deadline to the $30^{th}$ day of each month following the end of a quarter.

**Conclusion**

Allegacy's mission is to help our members make smart financial choices. We make every business decision with the best interests of our members in mind, and do not take unmitigated risks. Our highest priorities are member financial wellbeing and the safety and soundness of our credit union.

Under the proposal, Allegacy would continue to be a well-capitalized credit union, but we remain very concerned about the impact and constraints of the proposal in the future. There are many sensitive and potentially volatile components that go into the risk-based capital ratio. The level of uncertainty and complexity risk created by the risk-based capital requirements will directly affect our strategy going forward.

As a result, Allegacy will need to investigate, analyze, and conduct proper due diligence to determine what adjustments need to be made. We will have to consider changes to our balance sheet, internal systems, operations, products and services, as well as possible changes to our organizational structure and charter. Unfortunately, we will no longer be able to offer products and services based on member and marketplace demand – instead we will have to offer products and services that have lower risk weights and do not bring down our risk-based capital ratio. Further, the capital requirements will divert capital to maintain a well-capitalized cushion, and limit returns to members in the form of better rates. In the long run, this may lead to less members, lower deposits, and lower loan volume.

While we acknowledge the improvements in the revised proposal, we still think the risk-based capital requirements are costly, unnecessary, and unduly burdensome. The credit union's risk-based capital ratio will adversely affect strategic business decisions and growth plans. We believe this proposal will negatively impact our ability to serve our members both today and in the future. Allegacy is very concerned about the uncertainty, complexity risk, and increased regulatory burden that the revised proposal will bring.

Thank you again for the opportunity to comment on the revised proposal, and Allegacy respectfully asks that you consider the issues we have raised herein.

Sincerely,

Cathy J Pace

Cathy J. Pace
President & CEO

Cosby M. Davis III

Cosby M. Davis III
Executive Vice President & CFO