



April 24, 2015

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

RE: Comments on Proposed Rule: Risk-Based Capital

Dear Mr. Poliquin,

Wescom appreciates the opportunity to comment on the National Credit Union Administration Board's revised proposal for Risk-Based Capital (RBC2). Wescom serves the Southern California community, has 200,000 members and \$3.2 billion in assets. We appreciate the changes that have already been made including lowering the 10.5% well-capitalized requirement, lowering some of the risk weights, removing the treatment of interest rate risk, extending the implementation time frame and addressing the individual minimum capital requirements. However, many concerns with the newly proposed rule remain.

- **NCUSIF Deposit**

We strongly urge the NCUA to reconsider excluding the 1% National Credit Union Share Insurance Fund deposit from the calculation of risk-based capital. The NCUSIF deposit is a valid asset that can be refunded for a variety of reasons. It also acts as an additional buffer against NCUSIF losses, along with credit union capital. If a credit union converted to a bank charter, regulation would permit the inclusion of this deposit. The NCUSIF deposit should not be deducted from the risk-based capital numerator.

- **Mortgage Servicing Assets**

Rising interest rates and the potential negative impact on credit unions is understandably a major concern of the NCUA. However, interest rate risk can be reduced by retaining mortgage servicing assets (MSA). Therefore, the proposal to set the risk weight for MSAs at 250% is not reasonable. This weighting is excessive and creates less incentive to build a servicing portfolio which helps protect a credit union's earnings in a rising rate environment. In addition, retaining servicing helps maintain a strong relationship with members. The 250% risk weight is punitive for credit unions who want to do the right thing – build a strong relationship with members and reduce risk on their balance sheet. The risk weight should be set to 100%.

**Administrative Offices** 123 South Marengo Avenue, Pasadena, CA 91101

**Operations Center** 5601 East La Palma Avenue, Anaheim, CA 92807

**Mailing Address** P.O. Box 7058, Pasadena, CA 91109

Phone (626) 535-1000 • Toll Free (888) 493-7266 • Web Site [www.wescom.org](http://www.wescom.org) • e-mail [mail@wescom.org](mailto:mail@wescom.org)

- **Investments**

While we applaud the NCUA for revising most of the original investment risk weights to make them comparable with bank regulation, they are not entirely consistent. For those investments that are deemed “subordinated tranches,” the Board allows only for a 1250% risk weight or for the use of the gross-up approach. To be comparable to bank regulation, the use of the Simplified Supervisory Formula Approach (SSFA) must also be allowed. The SSFA is a simple and dynamic approach to allocate capital that takes into consideration the performance of the underlying securitized assets, as well as structural positioning of the tranche. It was adopted by the Basel Committee on Banking Supervision and is the industry standard for most banking organizations in the investment world. Given this status, Bloomberg created an SSFA screen to calculate the Securitization Risk Weight Factor. SSFA is an easy to use, transparent, and standardized calculation that can easily be incorporated into pre-purchase documentation and on-going surveillance. We urge the NCUA to include SSFA as a method for calculating risk weights.

Going forward, it should be considered best practice for regulations to be “modern and comparable” for all investors. As the Basel Committee develops and adopts new methodologies and rules, credit union regulation should adjust so that all market participants have a fair and equal chance of success.

- **Derivatives**

We understand the agency’s inclination to align the proposed risk weight calculations in Section 702.105 with other regulatory agencies, but given the derivative authority limitations under Part 703, Subpart B, the complexity of the bank calculation for derivative risk capital is unnecessary. The maximum Potential Future Exposure (PFE) will be very small given the notional size limitations under Part 703.103. Combined with the Part 703.104 requirement of a minimum \$250,000 daily margin transfer amount, a credit union’s risk-based capital required for derivatives will be insignificant. Given the NCUA’s desire to have credit unions use interest rate derivatives to protect against rising interest rates, we suggest a simple calculation be developed, for example x% of PFE, to capture a risk based capital amount for derivatives.

- **CUSO Investments**

We ask the NCUA to reconsider the proposed risk weight of 150% for investments in CUSOs. The current proposal erroneously gives all CUSO investments the same risk rating even though not all CUSOs pose the same level of operational risk. Given the range of services that a CUSO can perform the risk weight of 150% seems arbitrary and punitive. This blanket approach will hurt the value of existing CUSOs as the capital required to support them will significantly increase. It will also make it more difficult for credit unions to use CUSOs to diversify revenue streams and will serve to impede innovation. CUSOs promote collaboration and risk sharing and therefore, embody the spirit of the cooperative movement. CUSO investments should be risk weighted at 100%.

- **Implementation Timeline**

While we believe the proposed rule is unnecessary, we appreciate that the NCUA has proposed a significant delay in the implementation of RBC2, and encourage the agency to delay implementation even further until 2021, to coincide with the termination of the corporate stabilization fund, at which time credit unions will likely receive refunds. The refunds will be important to those credit unions that will need to increase capital levels in order to comply with RBC2.

- **Interest Rate Risk**

We appreciate the exclusion of interest rate risk (IRR) measures from the risk-based capital proposal and do not believe that a new rule is necessary. Wescom believes that the current IRR regulation (adopted just three years ago) which requires both a written policy on IRR management and a program to effectively implement that policy is sufficient. In that rule, the NCUA “acknowledges that it is not possible to establish a “one-size-fits-all” template of IRR management standards and metrics that would be appropriate for all federally insured credit unions. Rather, it recognizes that IRR management requires specialized judgments based on each credit union’s business objectives and ability to withstand risk.” We agree and believe that IRR should be addressed in the individual credit union examination and supervision process rather than in new regulation.

We are aware and concerned with the divergent opinions regarding this proposed regulation, including the various opinions as to the legality of the NCUA’s authority to issue such a rule. Congress has not expressly authorized the Board to adopt a two-tier risk-based net worth standard. NCUA Board Member J. Mark McWatters, the dissenting vote on the proposal, called the NCUA’s lack of legal authority the most “fundamental issue presented before the Board.” We believe this issue should be resolved prior to the issuance of any rule.

While we are pleased with the NCUA’s willingness to revise the proposal based on feedback, we are not convinced of the legality or necessity of this new rule. The benefits of this new regulation do not outweigh the costs to our industry. The bottom line is that capital requirements are not a substitute for proper credit union management. We believe that this is an overly complex, costly and unnecessary regulation and we urge the NCUA to reconsider its implementation.

Thank you for the opportunity to comment on this proposed rule and for considering our views on risk-based capital requirements.

Sincerely,



Irving Yu  
SVP Chief Financial Officer