Cooperative
Credit Union Association
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April 24, 2015

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

Cooperative Credit Union Association, Inc. Comments on Notice of Proposed Rulemaking on Risk-Based Capital
RIN 3133-AD77

BY EMAIL ONLY

Dear Secretary Poliquin:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc., please accept this letter of comment relative to the National Credit Union Administration's ("NCUA") second proposal governing risk-based capital ("RBC2"). The Association is the tri-state trade association representing credit unions located in the states of Massachusetts, New Hampshire and Rhode Island, serving over 200 credit unions which further serve approximately 2.6 million consumer members, and operating as part of the Credit Union National Association.

The Association is pleased that the NCUA considered the thousands of industry and congressional comment letters, emails and telephone inquiries provided in response to the first risk-based capital proposal, many of which were from Association members and our Congressional Delegations. Input from our local public officials in Congress on the risk-based capital proposal marked the first time a dialogue between our members, NCUA and Congress took place simultaneously during a proposed rule stage. The Association believes this effort was very productive and applauds the many recent changes to the proposal made by NCUA. Moreover, the NCUA's favorable response to the Association's September 8, 2014 request for a supplemental rule and additional comment period is acknowledged and appreciated. The NCUA's unprecedented level of engagement within the credit union system and before all stakeholders is not only appropriate given the impact of the proposed rule on credit unions, their growth strategies and ultimately on service to members, but also necessary. It is a threshold the Association encourages the NCUA to continue as part of future rulemakings.

With respect to the local impact of RBC2 on Association members, it should be noted that in Massachusetts, all credit unions remain currently well-capitalized; three (3) would have been adequately capitalized under the first proposal; and all remain well-capitalized under RBC2. In New Hampshire, all are well-capitalized and remain so under both versions of the proposal. In

Rhode Island, all credit unions are currently well-capitalized; two (2) would have been adequately capitalized under the first proposal; and all remain well capitalized under RBC2.

While the impact of capital levels remain universally strong under an RBC2 analysis, Association members noted that many business portfolios, plans for growth, and strategic vision will change as a result of the proposal. Therefore, it remains the position of the Association that the implementation of RBC2 will have a chilling impact on the industry and the pursuit of its mission. It is important for the NCUA to remember that credit unions operate in the best interests of their members. Credit unions often make loans that other financial institutions either have no interest in, or, of particular note, decline to make. Credit unions continue, especially in gateway communities, to fill the void left by others. The Association's members have made it clear that RBC2 has the potential to constrain their ability to make these loans in their communities, thereby further diminishing the options members of the community have.

The comments the Association has received on the changes credit unions would have to make regarding lending are stark, and illustrate a point made in our first comment letter and which deserves to be reemphasized: implementation of this rule will result in essentially allowing the NCUA to manage credit union growth, and the NCUA will be the final arbiter of how deep a credit union penetrates certain loan categories. This runs contrary to the credit union mission, which is to provide quality services that its members need. The rule as proposed will take away a credit union's flexibility as it attempts to keep its balance sheet in line with these strict capital requirements.

Finally, in preparation for the development of the present comment letter and to foster a local consensus, the Association again conducted letter writing workshops in each state, administered an industry survey and hosted a conference call. The top comment received by the Association from members about RBC2 is that it is unnecessary.

The remainder of this letter will elaborate on this top concern and address other key issues which Association members have brought to my attention.

I. Authority for RBC2 is Unclear and the Need for RBC2 and IRR Undocumented

It is without question that the authority of the NCUA to promulgate such a rule is unclear. Nothing speaks louder to this position than the comment letter provided by the former Chairman of the Senate Banking Committee, Alfonse M. D 'Amato, who oversaw the adoption of the language in question, directly to the NCUA during the proposal's first comment period. He noted that the adoption of risk-based capital provisions was intended to address adequately capitalized credit unions, not to establish a two-tiered system as NCUA continues to propose in RBC2.

In addition, the overwhelming majority of members have commented to the Association that the need for RBC2 is unclear. In doing so, they point to the performance of credit unions during the recent financial crisis, which is universally marked as the worst financial cycle since the Depression.

Yet during this period, credit unions performed very well and NCUA successfully mitigated any failures and ultimate losses to consumers without the proposed rule.

The Association also notes the absence of a unified agreement amongst the NCUA Board relative to the authority to propose the two-tiered risk-based capital system. While all stakeholders agree that capital levels are the overriding factor in maintaining a healthy credit union and system, the Association believes that the NCUA Board must be unified in this determination as the proposed rule has such sweeping implications for future growth of all credit unions.

Finally, even after the NCUA doubled the threshold as stated in the proposed rule, fewer than twenty (20) credit unions are projected to be adversely impacted. On balance, in light of the financial and managerial resources to be expended by the NCUA to implement the proposed rule, member survey respondents did not support finalization of the proposed rule. As a result, the Association directly questions the authority and need for the proposed rule.

Similarly, the NCUA has asked for input relative to future rulemaking relative to interest rate risk ("IRR"). In a unanimous response, members of the Association agreed that no new rules are necessary in the area of IRR, including within the current proposal. Because IRR varies widely amongst credit unions, NCUA already issued guidance as recently as 2012 which comprehensively addresses the management of IRR by written policy mandating both management and Board approval subject to examiner review. The Association recommends that future regulatory concerns in this area should be handled as part of the on-going supervision of credit unions. Such action could handily measure the effectiveness of current IRR policy at a credit union as well as targeted correction for any deficiency found in those credit unions in need of additional regulatory scrutiny.

II. The Association Commends the Agency for Favorable Changes

The Association would like to recognize the many favorable changes that were made in RBC2 over the original proposal. As you know, the Association strongly believed that a second comment period was necessary following the original proposal, and expressed the reasoning for this position in a letter directed to the Board. It is the position of the Association that were it not for our industry's fierce advocacy efforts, the proposed rule would have been released with many of the original policy issues, causing confusion and ultimately disorder within the industry.

The NCUA clearly made efforts in considering the specific comments of the credit union industry, and appreciation of those efforts is noted. One key improvement in RBC2 is the increase in the asset size threshold for coverage under the rule from $50 million to $100 million. Also notable is the change in the capital requirement for well-capitalized credit unions, which was lowered from 10.5% to 10%. While it is strongly emphasized that no risk-based capital rule is necessary, these changes represent an improvement.

Additionally, the NCUA devoted energy into improving many of the risk weightings, and reduced the number of concentration thresholds over which higher risk weights apply. Of particular note are the revisions to the weightings for member business loans, real estate loans, and certain investments. It was the position of the industry that risk weights needed to be calibrated to outliers, and the

NCUA responded to this concept. While the risk weightings need to be further simplified, and additional categories lowered, favorable changes already made were noted.

While RBC2 was clearly redrafted in direct response to specific credit union, league and association, congressional, and CUNA concerns, significant concerns remain regarding the rule and its necessity. Paramount is that no risk-based capital rule is necessary. However, should the NCUA proceed to issue a final rule, then further changes are requested.

III. Definition of "Complex" Credit Union Should Be Changed

The Association suggests that the asset threshold for compliance with RBC2 should be further increased to at least $500 million. This threshold was raised by the industry and previously rejected by NCUA in 2012 as part of the emergency liquidity regulation. This level also appears as an appropriate threshold in audit requirements. To advance meaningful regulatory relief, the Association endorses the approach utilized by other federal regulators in adopting the Small Business Administration's asset threshold of $550 million for determining "small entity" status.

The NCUA does not have a financial stability mandate or supervisory or regulatory authority over any financial institution requiring enhanced prudential standards necessary for maintaining financial stability.

In addition, members strongly believe that asset size should not be the sole factor dictating a complex credit union. Consideration must be given to the composition of portfolios and products and services offered to better identify complex credit union profiles. In this determination, the Association also urges the NCUA to annually index any threshold for growth and adopt exemptions from such classification wherever possible, such as for credit unions with more traditional products and services. Together with overall balance sheet risk, Association members noted that derivatives, credit union service organizations ("CUSOs") and member business lending are activities that may pose extraordinary risk, beyond routine loans and investments, for which additional capital protection may be needed.

IV. Comprehensive Written Strategy for Capital Should Be Eliminated

The Association strongly opposes any capital adequacy plan within the proposed rule. It is unquestioned that credit unions possess a lower risk profile. Moreover, the average financial strength of Association members speaks clearly:

Massachusetts: 10.81% capital and 0.63% delinquency
New Hampshire: 10.55% capital and 0.48% delinquency
Rhode Island: 10.30% capital and 0.73% delinquency

At a minimum, most credit unions incorporate capital adequacy into their operating budgets as well as their strategic plans. Policies and Board reporting procedures are also commonly in place to manage concentration risks and long term asset risks. Other credit unions vest this responsibility for review and control through their asset liability management committees. One credit union noted that while concentration analysis is performed on a quarterly basis, it is accompanied by up to fifteen (15) pages of commentary and written analysis.

Regardless of the mechanism, several Association members noted that capital levels and risk are reviewed monthly. Any provisions which may result in requiring higher capital levels or changes in a credit union's planned capital levels beyond current capital levels is therefore not supported by the Association. Assessing capital adequacy levels at the local level preserves capital strategies to balance risk which does not automatically translate into systemic rules. Systemic efforts lead to a one size fits all approach, which the Association again asks the NCUA to reject as it punishes credit unions that work with each member as challenges arise to manage risk while delivering service.

Concerns of the NCUA relative to the maintenance of appropriate levels of capital and a comprehensive written strategy may be more properly directed to credit unions operating below the adequately capitalized category as sound public policy dictates.

V. Risk Weightings Should Be Lowered

As previously mentioned, the Association commends the NCUA on its commitment to lowering many of the risk weightings that were flawed in the original proposal. Of particular note were the changes in risk weights for higher concentrations of real estate and member business loans, and the treatment of 1-4 family non-owner occupied mortgage loans as residential loans with a lower risk weighting than if they were considered member business loans. It is the Association's position, however, that many of the risk weights remain too high. As with the first comment letter, risk weightings are strongly opposed that exceed Basel III standards for small banks, as credit unions have different and varying considerations in managing risk.

The risk weights for mortgage loans remain a serious concern. Mortgages are a staple product of our region's credit unions. Specifically, current first lien residential mortgage loans, and current and non-junior real estate loans over 20% of assets have higher risk weights than those assigned to banks. The risk weights of mortgage loans should be lowered as credit unions do not present high levels of risk for these products.

The Association also received many comments from members regarding mortgage servicing risk weights ("MSRW). 88% of survey participants responded that the 250% risk weighting is significantly higher than necessary. Such a risk weight is significantly higher than the risk weight for the underlying mortgage sold to create the MSRW. Credit risk, which is the proper focus in a risk based capital proposal, is the same in both situations and therefore a higher risk weight is not warranted. Similarly, first and second lien mortgage loans should have the same risk weights under circumstances in which the same credit union originated both mortgages as the same credit risk criteria and due diligence was used to underwrite the loans from the beginning regardless of subsequent sale.

Furthermore, comments received by the Association reflect that mortgage servicing is improperly characterized by NCUA under RBC2 as a complex activity. MSRW possess a prepayment risk and an operational risk which can be managed by healthy origination and participation levels as well as internal controls. Industry guidance and examinations to date reinforce the clear position of NCUA that interest rate risk is a top concern and must be very carefully managed. NCUA has further expanded this concern to view MSRW as complex. As a result, credit unions comply with these directives by selling mortgage loans to government sponsored enterprises and others. The sale of such mortgages and the corresponding creation of the MSRW is not only an asset, but also a premier way that credit unions can manage and retain the member relationship given regulatory constraints. For Association member credit unions, given their geographic location, housing stock and history, this activity is customary, not an exception, to traditional credit union service and has proven to successfully withstand decades of challenging economic cycles. Without further adjustment, the Association believes that the NCUA fails to consider the uniqueness of credit unions and their valued member relationship. In essence, the concern of the Association is that credit unions in possession of MSRWs will be penalized and forced to trade off member value for balance sheet convenience under RBC2. The risk weights for this type of activity should be significantly lower.

Another area of acute concern amongst our members is in the treatment of unconsolidated CUSO investments. It is our position that unconsolidated CUSO investments should be weighted the same as CUSO loans. The NCUA must take into consideration the value CUSOs provide to the credit union industry, and should encourage continued collaboration. The current extremely high risk weights do not consider the financial, managerial strength, or record of performance of a CUSO. During comment letter writing workshops, credit unions repeatedly noted that full consideration would be given to the discontinuance of products and relationships if the risk weightings were to remain at current levels. CUSOs reflect the unique collaboration of credit unions and ultimately provide products and services that credit union members benefit from, and this value would be inhibited by the current rule.

Finally, as noted in the Association's first comment letter, the NCUA is urged to take all necessary steps to preserve the Federal Home Loan Bank's Mortgage Partnership Finance and Purchase Programs without penalty. Such programs are risk adverse, popular, useful tools for Association members.

VI. All Goodwill Should Be Included in the Risk-Based Capital Calculation

The original RBC proposal sought comment on whether goodwill and other intangible assets, which were excluded in the proposal, should be included in the numerator of the risk-based capital ratio, and the Association at that time provided comments supporting this inclusion. While RBC2 made improvements in that supervisory goodwill is grandfathered in to the calculation until 2025, further improvements are necessary.

Under the second proposal, a credit union can include in the numerator of the RBC ratio goodwill that arises from supervisory merger transactions, defined as assisted mergers, emergency mergers, or mergers where the NCUA or state supervisor selects the surviving credit union, completed prior to the effective date of the final RBC rule, until 2025. It is the position of the Association that this provision is arbitrary and does not go far enough. All types of goodwill, both non-supervisory and supervisory, should be included in the calculation without a time limit. Goodwill should continue to be measured against the standards of Generally Accepted Accounting Principles ("GAAP") requirements.

Goodwill is a valid asset, classified under GAAP, which has real value. Both RBC proposals treat goodwill as valueless, which is an inaccurate approach. Goodwill has value in merger transactions and is an incentive, which can often be a favorable approach. It is the observation of the Association that mergers are the current local trend amongst mid-size credit unions. Individual credit unions which, for a multitude of reasons, believe they should not continue alone and who choose to merge, ultimately create stronger financial institutions. Mergers can have a favorable impact on safety and soundness and also reduce exposures for the National Credit Union Share Insurance Fund ("NCUSIF"). Excluding non-supervisory goodwill may discourage these credit unions from making these sound decisions.

For these reasons, the cutoff date of January 2025 for supervisory goodwill must be removed so that supervisory goodwill can continue to be counted as an asset. As a result, the final proposal must also include all types of goodwill in the calculation of the RBC ratio.

VII. NCUSIF Deposit Should Be Included in the Risk-Based Capital Calculation

Decades ago, the credit union system had the wisdom to capitalize its own separate, federal insurance fund for the benefit of its members. This unique business decisions and its current market value should not be overlooked by the NCUA. The one percent (1%) deposit made by all federally-insured credit unions to the NCUSIF is an asset which should be properly included in any risk-based capital calculation. The Financial Accounting Standards Board ("FASB") permits the recognition of such deposit under GAAP. The majority of Association survey respondents seek the inclusion of the 1% deposit into the risk-based capital ratio.

VIII. Supplemental Capital Should Be Included for All

The overwhelming majority of the Association's members also supported the use of supplemental capital for all credit unions. The need for capital modernization continues as credit unions experience the challenges not only of external factors such as economic cycles, but also those such as social media and Bank Transfer Day, with no alternatives for growth opportunities beyond their ability to generate retained earnings. The need for increased earnings through managed risk is stronger than ever and a critical component of capital modernization which coincides with one of the goals of the proposed rule.

The Association is pleased that NCUA has acknowledged the need for supplemental capital for credit unions before Congress and most recently in the formation of a working group on the topic for certain credit unions. The Association strongly supports these efforts and urges the NCUA to extend its work to incorporate supplemental capital for all credit unions. If the proposed rule is finalized, then there is ample room for its inclusion into the risk-based framework. Whether supplemental capital is included in RBC2 or a separate proposal, credit unions seek such a tool to increase loan portfolios and other growth opportunities within the not-for-profit cooperative structure.

IX. Impact on State Chartered Credit Unions Should Be Considered

The Association strongly urges the NCUA to develop a coordinated strategy with all state regulators relative to the promulgation of any changes to capital rules. Historically, Association member credit unions have witnessed differences in regulatory interpretations between the NCUA and state regulators. In addition, the supervision of the NCUSIF always seems to be the driving factor for the NCUA to take a lead position or justify its application of a rule to Association members, whose state chartered credit unions are all federally-insured. The loan participation and emergency liquidity rules are recent examples of the exercise of such authority. It is a top priority of the Association to promote a robust dual chartering system and advance communication and coordination with the NCUA's state counterparts.

In addition, there are many state laws pending, regulations in the process of being promulgated and new state laws that will impact the application of RBC2 for credit unions. For example, both Massachusetts and New Hampshire are currently considering recodifications of credit union law, Senate 552 and SB 188, respectively. Further, Massachusetts is preparing changes to its parity regulations as well as implementing recent changes to its Legal List of Investments, Ch. 343 of the Acts of 2014. By example, Massachusetts credit unions would be at a disadvantage implementing a 300% risk weight for certain investments permitted under state law, as well as the funding of employee benefit investments. Furthermore, it is expected that the required NCUA call report changes anticipated under RBC2 will have a direct impact on these provisions and a coordinated strategy amongst regulators will greatly reduce the compliance regulatory burden on credit unions.

Concern clearly exists that state chartered authority may be undermined through the adoption of a final RBC2 rule. The Association strongly urges all regulators to agree and clearly disclose to state chartered credit unions their final determination as to who is responsible for establishing, monitoring and enforcing the capital plan.

The Association also notes that many state chartered credit union regulators, such as those that supervise Association members, also serve in a dual capacity working with other federal regulators and insurers of banks. In the event that RBC2 proceeds, the Association urges the NCUA to take necessary steps to promote consistency and minimize confusion in both process and substance which may arise in any final risk-based credit union capital provisions.

X. A Comprehensive Cost-Benefit Analysis Should Be Undertaken

The impact of a new rule on risk-based capital cannot be overstated. While the NCUA made attempts to simplify aspects of the rule, any risk-based capital rule that is released will be complex. What is more, an RBC regulation will impact all levels of a credit union's operations. While other regulations may only impact a specific area of a credit union, risk-based capital considerations take place from top to bottom. Therefore, many more individuals within each credit union must have a firm understanding of the requirements under the rule.

Association members throughout the comment period universally noted that the proposed rule will increase their compliance costs. Key focus areas include costs to train staff, purchase new software, administrative/compliance costs and implementation time costs. None of the Association's survey respondents plan to hire additional staff in response to the proposal at this time. Rather, staff time will be redirected away from current from every day member service to address RBC2. This fact is equally as important in evaluating cost and impact.

Another important area of change would be in balance sheet composition. In the Association's survey, members were asked whether their balance sheet composition would be altered if the proposal were enacted in its current form. The large majority of participants responded that it would. The responses varied from the rule constraining a credit union's ability to make more loans in its community, to a change in strategic direction over a course of years, to operational changes to ensure that the credit union maintains a well-capitalized position, to a reallocation of balance sheet items, to having to reevaluate growth in and readjust loan portfolios. As major real estate lenders and servicers, credit unions will be forced to make significant changes to their product offerings without amendments to RBC2.

XI. RBC2 Implementation Should be Delayed

The Association commends the agency for its positive change in position regarding implementation time from the original proposal to RBC2. The original timeframe of 18 months was significantly too short of a time period for the industry to grasp and implement the changes the rule imposed. RBC2 has a delayed compliance date of January 1, 2019, which allows roughly three and a half years for implementation. While this was a vast improvement, the change in the implementation of the rule is not enough.

The NCUA should consider either a further delayed implementation date, or a phase-in or tiered implementation process. One important aspect that has not been addressed fully is the accompanying changes that will need to be made to call reports due to the rule. Under no circumstances does the Association support changes to call reports until RBC2 is fully implemented. In the alternative, a tiered approach, one that has been endorsed by the FDIC, in terms of years and asset size may be considered. The benefits of a tiered implementation process would allow a credit union to adopt changes to the call report at the same time as the rule is implemented and the credit union will be held subject to the rule. This will avoid a credit union having to manage two competing scenarios at one time.

The Association also strongly urges the NCUA to consider the substance and timing of the finalization of the FASB credit impairment proposal on RBC2. At a minimum, RBC2 implementation must be delayed so that credit unions can understand and coordinate compliance with the FASB rule. Moreover, it is the position of the Association that any final FASB rule will require dialogue and coordination between the NCUA and FASB with respect to credit union forecasting models to minimize differing examination guidance.

At the very least, due to the significant changes a credit union will face and the time it will take to readjust to the new rule, a five (5) to seven (7) year timeframe would be appropriate. The timeframe should be significant enough for each credit union affected by the rule to have an opportunity to adopt a plan for the NCUA's review and approval. In addition, in light of the health of the credit union system, the NCUA can afford to provide more time, on a reasonable basis, that will facilitate the development of its own examination resources and training for its examiners as well as provide additional time for covered credit unions to make any strategic and operational changes they need to prepare for RBC2.

NCUA is also encouraged to include in the final rule a commitment that the Board will host a public process to review the final RBC2 well in advance of its effective date to assess the extent to which the need and substantive provisions still are warranted.

XII. Conclusion

The Association unequivocally asks the NCUA to withdraw the proposal in its entirety due to the absence of authority or need. In the alternative, I urge that the NCUA consider the concerns voiced by Massachusetts, New Hampshire, and Rhode Island credit unions, and make the changes detailed above.

As a concluding request, I further urge the NCUA to review the proposal in its entirety, if it is not withdrawn, exclusively for the purpose of reevaluating the cooperative nature of credit unions and RBC2. It is imperative that any final risk-based capital rule properly balance potential NCUSIF losses with the vision of a credit union's management and Board to develop and implement strategic plans and products and services that best serve its membership. Association member credit unions are well capitalized, responsibly managed and possess a demonstrated track record of assessing risk. I ask that these factors serve as the guide to NCUA in proceeding with any new risk-based capital rule.

Thank you for your consideration of these views. The Association appreciates the opportunity to provide input and I remain available to address any questions or concerns at 508.229.5623 that you or your staff may have at your convenience.

Sincerely,

Paul C. Gentile
President/CEO

PCG/mabc/kb