

for Credit Unions

April 27, 2015

Via E-Mail
regcomments@ncua.gov

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

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

Dear Mr. Poliquin:

In its proposed rule issued for comment in January 2015 (80 FR 4339) (the “Proposed Rule”), the National Credit Union Administration (“NCUA”) proposes to replace the NCUA’s current risk-based net worth ratio with a new risk-based capital ratio for federally insured natural person credit unions (“FICUs”). This letter is submitted by the Board of Trustees of Trust for Credit Unions (“TCU”) in response to NCUA’s request for comments on whether the Proposed Rule is understandable and minimally intrusive. We believe that the rule is unnecessary given credit unions’ historically strong capital base. Further, as noted by other commenters, the NCUA has not established the legal authority to implement a risk-based capital requirement for credit unions, and the rule is unnecessarily complex, particularly for investments. Rather than employing the proposed rule as written, we suggest that the proposed risk-based capital ratio be employed as a tool to be used by examiners, much like the NCUA’s use of interest rate risk analysis.

About TCU.

TCU is an open-end diversified management investment company registered under the Investment Company Act of 1940 (the “1940 Act”) and the Securities Act of 1933. Mutual funds advised by TCU (the “TCU portfolios”) are offered only to federal credit unions (“FCUs”) and state chartered credit unions. Shares of each TCU portfolio are designed to qualify as eligible investments for FCUs pursuant to Sections 107(7), 107(8) and 107(15) of the Federal Credit Union Act (“FCUA”), Part 703 of NCUA Rules and Regulations and NCUA Letter Number 155, and may or may not qualify as eligible

investments for particular state chartered credit unions. Each investment practice and technique that may be used by the TCU portfolios is permitted by the 1940 Act but utilized only to the extent permitted by NCUA Rules and Regulations. Callahan Credit Union Financial Services, LLLP (“CUFSLP”), a Delaware limited liability limited partnership in which 37 credit unions are limited partners, acts as the administrator of the TCU portfolios. For over 25 years, TCU has helped its credit union shareholders invest excess member deposits and provide an investment alternative intended to enhance the credit unions’ cash management. Section 703.14(c) provides that an FCU may invest in a registered investment company or collective investment fund, as long as the prospectus of the company or fund restricts the investment portfolio to investments and investment transactions that are permissible for FCUs.

Treatment of Mutual Fund Investments Under the Proposed Rule

The “full look through” approach described in the Proposed Rule fails to apply risk weights to mutual fund investments in a consistent manner to the holding of the same securities by FICUs directly. For instance, an FICU that held “U.S. Treasuries and Government Securities” would assign a risk-based capital weight of 0 percent to these holdings. In contrast, an investment fund, even if it invested its assets only in Part 703 permissible investments that were U.S. Treasuries and Government Securities, would have a risk-based capital weight of 20 percent assigned to this asset. This disparity in the treatment of the same asset when held by two different entities unnecessarily discriminates against FICU investments in mutual funds by penalizing FICUs for making the same investment indirectly that they could otherwise make directly. Further, the added layer of risk that the Proposed Rule assumes will be present for indirect investments is not a factor with mutual funds such as the TCU portfolios, which provide daily redemption at net asset value and generally wire the proceeds of a sale of shares to the investor on the next business day.

The Proposed Rule also unnecessarily limits FICUs in that the diversity of an investment fund’s portfolio and variations among investment funds’ risk profiles will not be recognized when looking at investment fund assets in FICUs’ risk-based capital ratios. For instance, the risk-based capital ratio of an investment fund that holds 10% of its assets in cash, 65% of its assets in U.S. Treasury securities and 25% of its assets in conditionally guaranteed non-subordinated obligations of the U.S. Government would have risk-based capital ratio of 20 percent, even though the underlying assets, if held by an FICU directly in the same proportions, would have a combined risk-based capital ratio of 5 percent. Additionally, the Proposed Rule would provide the same risk-based capital ratio of 20 percent to an investment fund that invested 100% of its assets in conditionally guaranteed non-subordinated obligations of the U.S. Government, although these underlying instruments would themselves have a risk-based capital ratio of 20 percent, indicating a higher risk that is masked by the Proposed Rule’s feature of rounding up 0

percent and 20 percent instruments into a single 20 percent risk weight for investment fund assets.

Suggested Revisions to the Proposed Rule.

We suggest that the NCUA revise the regulation so that each FICU applies the risk weights to mutual funds in a consistent manner. The TCU portfolios are permitted to hold only Part 703 permissible investments and invest a high proportion of their assets in obligations of the U.S. Government and unconditionally guaranteed obligations of U.S. Government agencies. These instruments, if held directly by FICUs, would have a risk weight of 0 percent under the Proposed Rule. However, the Proposed Rule would result in all investments held by mutual funds such as the TCU portfolios to carry a 20 percent risk ratio, regardless of the actual risk ratio of the underlying assets. We suggest a full look-through approach that is attuned to the distinctions between underlying assets that would allow low-risk mutual funds to carry risk ratios ranging between the 0 percent and 20 percent based upon the actual risk ratio of their holdings.

We also suggest that the Proposed Rule operate as a tool to be used by examiners rather than a requirement to determine whether FICUs meets the NCUA's definition of "Well Capitalized" or "Adequately Capitalized." We agree with other commenters that the risk-based capital ratio, like interest rate risk, is better employed by examiners as a tool to determine whether FICUs being examined should receive greater scrutiny rather than as an additional test to determine whether an FICU is well capitalized or adequately capitalized.

We also suggest that the Proposed Rule be clarified to indicate the timing of "the most recently available holdings reports" that are to be used by FICUs employing the full look-through approach for their analysis of investment fund assets. The TCU portfolios annually provide an updated prospectus to investors, and this annual update provides an opportunity for the measurement of the TCU portfolios' assets for FICUs employing the full look-through approach. We suggest that the holdings of an investment fund be measured as of that fund's prospectus date and be updated at least annually. Alternately, an FICU that is measuring the risk ratio of its holdings in an investment fund should have the discretion to determine how often to measure the assets held by an investment fund.

Conclusion.

In short, the Proposed Rule pursues a beneficial goal of measuring risk, but regulates too broadly and does not recognize distinction among investments. Risk-based capital analysis may be helpful as a tool for increased scrutiny in an examination, but investment risk ratio should not be used to categorize FICUs that are otherwise well capitalized or adequately capitalized into the lower capitalization category. Additionally, while the look-through approaches delineated under the Proposed Rule can be helpful in

Mr. Gerard Poliquin
April 27, 2015
Page 4

assessing the risk levels of assets held by investment funds, the use of a risk level floor to combine all underlying assets at the 0 percent and 20 percent risk weight categories severely limits the usefulness of the full look-through and unfairly penalizes FICUs for investing in low-risk liquid mutual funds.

* * * * *

Thank you for the opportunity to comment on the Proposed Rule. TCU would also greatly welcome an opportunity to discuss further (in person or via teleconference) any revisions to the Proposed Rule that could benefit credit unions, whether set forth in this letter or proposed by others. Please do not hesitate to contact me at 415-442-5811 or counsel to TCU, Mary Jo Reilly, at 215-988-1137.

THE BOARD OF TRUSTEES OF
TRUST FOR CREDIT UNIONS

By: 
Eugene A. O'Rourke, Chairman

cc: Rudolf J. Hanley
Stanley Hollen
Gary Oakland
James F. Regan
Julie A. Renderos
Wendell A. Sebastian
Michael Steinberger, PhD
Daniel P. Dawson, Esq.
Charles W. Filson
Jay Johnson
Mary Jo Reilly, Esq.
Michael P. Malloy, Esq.