ROYAL CREDIT UNION

April 25, 2015

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

Royal Credit Union
Charter: 66834

Dear Mr. Gerard Poliquin:

The purpose of this letter is to express my comments on NCUA's second proposed Risk-Based Capital rule (RBC2).

I am writing on behalf of Royal Credit Union (RCU). RCU is a $1.6 billion community chartered credit union serving 155,000 Members with 26 traditional branches and 27 school site branches. The following is a very brief overview of RCU:

- We have a 100% loan-to-deposit ratio.
- Following is our loan penetration:
  - 32% Consumer Loans
  - 25% Real Estate Loans
  - 43% Member Business Loans
- Our net worth ratio is over 11%.
- Our net charge-off ratio is less than NCUA peers.
- We have been a Member business loan lender for the past 35 years. Given the size of our portfolio and the length of time successfully being a Member business loan lender, we are a resource for the credit union community.
- Since 2012, we bucked the "fee income" trend that is being experienced in the financial industry and we have actually decreased our punitive fee income, which has been a $4.5 million benefit to our Members.
- The bulk of our membership has a moderate, at best, level of income. Per NCUA's December-2014 financial performance results (FPR), our Members have an average deposit balance of $8,415 compared to our NCUA peers at $11,705. Our Members carry an average loan balance of $11,757 as compared to our NCUA peers at $16,621.

CUNA President Jim Nussle has summed up the RBC2 situation very well…."a risk based capital rule is a solution in search of a problem that does not exist". Credit unions fared very well in the aftermath of the great recession. Prior to the great recession, large complex credit unions had an average net worth ratio of 11.11%. After bottoming out at 9.68% in 2009 (which is well above the NCUA 7% well capitalized level), the average large complex credit union had a net worth ratio of 10.71% at the end of 2014. As Mr. Nussle says, "where's the problem?"

Should NCUA feel compelled to go down this road, I would offer up the following comments on the proposed RBC2 rule.

- RBC2 increases the risk weighting on real estate and commercial loans to 150% when the concentration exceeds a certain percentage of assets. I would contend as concentrations increase, a prudent credit union will have increased expertise to manage the concentration and thus the higher concentration would have a lower risk to the share insurance fund. Using NCUA's FPR reports, RCU's average 10-year NET CHARGE-OFF ratio ending December 2014 is 70 basis points while our NCUA peer average is 69 basis points. I find it very compelling that even with losses due to the worst economic downturn in 80 years, our balance sheet and its concentration of Member business loans is no more risky than our average credit union peer. I strongly feel the risk weightings should not be increased from 100% to 150% based solely on concentration due to the facts from above
- Royal Credit Union has "goodwill" on our balance sheet. Goodwill is reviewed for impairment during our annual external audit. The goodwill was the result of the purchase of some bank branches. The branches have grown to become a very important part of our operation. If we would ever choose to re-sell these branches, the gain on sale would dwarf the amount of goodwill on our books. This asset should not be treated differently after 2025.
- The final rule should contain approval to use Supplemental Capital to supplement a strong balance sheet. The RBC2 rules move capital needs to 10% and Supplemental Capital will help insure credit unions can continue to grow and serve all Members, not just very profitable Members.
- Mortgage Servicing Rights (MSR) carry a risk weighting of 250%. MSR's should carry no more weight than a saleable investment. Our MSR asset is valued quarterly by MIAC...a Mortgage Industry expert. MSR's are actively traded on the open market thus the value of the asset can be reasonably determined.
- Chairman Matz has said 2015 will be the year of Regulatory Relief. But the RBC2 rules and commentary infer NCUA will be releasing new Interest Rate Risk (IRR) rules in the near future. Over the last several years, NCUA has release several rules that address IRR. These rules are very comprehensive and more than adequate. We do not need any more regulatory rules pertaining to IRR.
- The implementation of RBC2, in any form, should be delayed to 2021. This is when it is expected credit unions will get refunds from Corporate Stabilization Fund. In our case, we expensed over $8 million. The actual losses are estimated to be much less than planned for,

thus credit unions should see a good part of our assessments returned. If not delayed, NCUA should supply credit unions with the estimated balance in the Corporate Stabilization Fund as of 2021 along with each credit union's potential reimbursement. This should be allowed to be put as a receivable on the balance sheet and be included in the net worth computation.

And finally, NCUA must not lose sight of the proposed rule's potential impact on future credit union industry growth. Currently, most credit unions have an ample "cushion" of net worth over the current well-capitalized threshold of 7%. As of March-2015, our capital ratio of 11.19% gives us a 419 basis point cushion above the current well capitalized threshold. The currently proposed RBC2 rules would reduce our "cushion" to 284 basis points. There always seems to be unintended consequences to most actions, and it would be disappointing to look back after ten years and see this rule negatively impacted industry growth.

Our CEO is a very Member focused person. Whenever I propose a new idea to our executive team to reduce risk, our CEO always says...."don't manage by exception!" He goes on to say, we are not going to negatively impact the masses only to stop a few negative occurrences.

NCUA, I challenge you, **DO NOT MANAGE BY EXCEPTION**.

I am available for questions at 715-833-8135 or jonh@rcu.org.

Thank you for taking the time to read my letter.

Sincerely,

Jon Hehli

Jon Hehli
EVP-CFO