VIA EMAIL TO: regcomments@ncua.gov

April 27, 2015

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

RE: Risk-Based Capital Proposed Rule (RIN 3133-AD77)

Dear Mr. Poliquin,

Thank you for the opportunity to comment on the National Credit Union Administration's (NCUA) Risk-Based Capital Proposed Rule (Proposed Rule). The NCUA has made commendable changes to the proposed risk-based capital (RBC) regulations since the original issuance of a proposed rule in January of 2014.

Throughout the Proposed Rule, the NCUA suggests it was written to be more consistent with Other Federal Banking Regulatory Agencies (Other Agencies). The overall credit union industry has consistently been devoted to servicing their members differently than banks. Credit unions have proven to be an economic force in local markets and softened the effects of the recent economic downturns to its members. The overall credit union industry is not looking to be more consistent with banks and has devoted time to being cooperative in nature.

The Proposed Rule remains fundamentally flawed. The following elaborates on the significant areas of concern of the Proposed Rule and addresses certain key issues the NCUA should address.

A Separate Interest Rate Risk Rule is Unnecessary

As the NCUA removed interest rate risk (IRR) from the Proposed Rule, the proposal implies future IRR regulation is necessary. The issuance of an Advance Notice of Proposed Rulemaking is strongly encouraged if the NCUA decides to issue an IRR proposal in the future. This will enable the NCUA to receive constructive feedback prior to deciding on issuing such a proposal.

While the removal of the IRR component within the Proposed Rule is appreciated, the current NCUA supervision and examination process to credit unions is more than adequate to address IRR concerns. Adding additional regulatory burden to credit unions strictly based on asset size is not necessary. The NCUA should develop a more robust method to identify potential credit union outliers that raise IRR concerns.

Maintain the Current Prompt Corrective Action Regulations

The NCUA's prompt corrective action (PCA) regulation was established for some time. Since such establishment, there have not been significant modifications to the PCA by the NCUA. This includes the most recent review performed as part of the NCUA's rolling three year review of regulations in 2012. This analysis was performed subsequent to the NCUA's December 19, 2011 response, included in the January 4, 2012 United States Government Accountability Office (GAO) Report (GAO-12-247) to Congress. The NCUA's response indicated that credit unions performed very well during the worst financial crisis since the Great Depression and the NCUA effectively prioritized resources to mitigate losses. The Proposed Rule is not necessary; the NCUA should maintain the existing PCA regulation.

Congress' Intention of a Credit Union Single-Tiered System

As communicated to the NCUA by certain Members of Congress, certain members of the NCUA, and reputable attorneys, Congress intended to limit the risk-based net worth (RBNW) standard to a single-tier system. This Proposed Rule establishes a separate RBNW requirement for "well-capitalized" and "adequately capitalized" credit unions. This two-tier system is inconsistent with the intent of Congress. These other individuals who have expressed their concern over the NCUA's disregard to Congress' intent of a single-tier system are reputable and distinguished, who understand the interpretation of Congress far better than I, although we all have arrived at the same concern of the Proposed Rule establishing a two-tier system. The NCUA should follow the intent of Congress as written in the Federal Credit Union Act (FCUA), "the Board shall designate 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."

Despite our belief of this Proposed Rule going beyond the authority provided to the NCUA by Congress, we are providing the following comments based on the likelihood that the NCUA chooses to move forward with implementation of a Risk-Based Capital (RBC) rule.

Other Supplemental Forms of Capital

I urge the NCUA to extend its work on incorporating supplemental capital for all credit unions. The NCUA's efforts are strongly supported and the need for capital modernization continues as credit unions experience challenges with no alternatives for growth opportunities beyond net income accumulating into retained earnings. Credit unions seek supplemental capital as a tool to increase loan portfolios and other growth opportunities for its cooperative plans and goals. If the Proposed Rule is finalized, it should include other supplemental forms of capital within its framework.

Asset Size Should Not Define a Credit Union as Complex

The Federal Credit Union Act (FCUA) provides that the NCUA may only adopt RBNW rules for "insured credit unions that are complex, as defined by the Board based upon the portfolios of assets and liabilities of credit unions." While the increased threshold of $100 million represents progress, it still disregards the composition of assets and liabilities of individual credit unions. A change in the NCUA's definition of "complex" is warranted.

I also recommend the NCUA, within its revised definition of complex, increase the proposed asset threshold from $100 million to $1 billion. This threshold should be used in combination with actual operational complexity as measured by the NCUA's Complexity Index. The NCUA discussed a Complexity Index as part of the supplemental information. Thus, it is proposed that all federally insured credit unions with assets under $1 billion be considered non-complex, and that only those credit unions with assets above $1 billion and a Complexity Index value of 20 or higher be required to meet risk-based capital provisions.

Requirements for Capital Adequacy is Unclear

As mentioned above, the Proposed Rule defines a credit union as complex based on an asset threshold of $100 million. The Proposed Rule goes on to state that complex credit unions "must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital" and "the nature of such capital adequacy assessments should be commensurate with the credit union's size, complexity, and risk-profile." The vague requirement for credit unions to have a comprehensive written strategy poses excessive regulatory burden to credit unions. The Proposed Rule does not provide detailed guidance as to how a credit union's capital adequacy plan would comply and states that the NCUA plans to revise the National Supervisory Policy Manual for examiners to ensure credit unions. It is difficult for credit unions to comment on the extent of the burden of written capital adequacy as it is not outlined within the Proposed Rule and the revisions to the manual were not discussed.

The Proposed Rule's Paperwork Reduction Act estimates the additional data collection requirements for an estimated 1,455 complex credit unions to be a one-time 40 hour burden, or $1,276 cost per credit union. The Proposed Rule does not incorporate the estimated burden for establishing a comprehensive written strategy for maintaining an appropriate level of capital. This written strategy will be a much greater burden on complex credit unions upon the implementation year and for ongoing years. The NCUA's final rule of Capital Planning and Stress Testing (Stress Testing) estimated 4 credit unions would be impacted by this Stress Testing ruling with an estimated 750 hours of paperwork burden in the initial year and 250 hours in subsequent years. I do not believe the burden for a written strategy for capital adequacy is similar to the burden for Stress Testing requirements; although I do believe at least 75% of such hours will be necessary for credit unions to properly establish a comprehensive written strategy for capital adequacy. This cost would estimate to be $17,944 per credit union or $26.1 million to the industry for the initial year of the final RBC rule. The NCUA must revisit the overall requirements for capital adequacy prior to finalizing the RBC rule. I believe credit unions currently have adequate capital adequacy policies, processes and procedures in place and the NCUA should remove the requirement of a written strategy from the final RBC rule.

Decrease the Minimum Capital Requirement

The NCUA's effort to decrease the minimum RBC requirement from 10.5% to 10.0% in the revised Proposed Rule is appreciated, but further reduction is necessary. The NCUA's basis for the minimum capital requirement was mainly derived from Other Agencies' regulation. The ruling does not consider the uniqueness of credit unions when deriving the minimum RBC requirement.

The overall credit union industry is not looking to be more consistent with banks and has devoted time to being low-risk, cooperative institutions. The strong performance of credit unions throughout the financial crisis demonstrates there is no need for significant RBC requirements. This is consistent with the NCUA's statement in the GAO Report to Congress as referenced above. The NCUA should further decrease the minimum RBC requirement prior to implementation of a final rule.

Implementation of the Final RBC Rule Should be Beyond 2019

I commend the NCUA for recognizing an effective date of eighteen months was not reasonable. The revised Proposed Rule has an effective date of 2019, or approximately four years. It is unclear when the NCUA will implement the changes needed on the Call Report system to require information for calculating the RBNW under the final RBC rule. Therefore, credit unions are left to comply subsequently, which is assumed to be a few years from the final rule. Other Agencies provided seven years with a phase-in requirement. As the NCUA chose to utilize Other Agencies as a guideline for this Proposed Rule, the final rule should have a similar seven year implementation period or beyond.

An additional consideration for the NCUA to further delay the implementation of the final RBC rule is the year of the liquidation of the Temporary Corporate Credit Union Stabilization Fund which occurs in 2021. This will be an appropriate measure for the overall credit union industry and will enable this distribution to become part of the calculation in determining a credit union's RBNW.

Align Risk-Weights for Credit Unions Not Banks

The Proposed Rule indicates the goal is to address credit, concentration, liquidity, operational, and market risks when applying the risk-weights proposed. The challenge is that in reading the Proposed Rule, there is no explanation of which portion of the proposed risk-weight is intended to address each of these risk elements. The NCUA should be consistent with Congress' direction that "design of the risk-based net worth requirement should reflect a reasoned judgment about the actual risks involved." It is difficult to provide valuable comments since the details are not defined.

Additionally, many of the risk-weights are determined per the Proposed Rule to be comparable to risk-weights established by Other Agencies. Credit unions are not banks. The NCUA ignores how credit unions handled the effects of the recent economic downturns to its members as well as the cooperative nature of credit unions. Credit unions are known for promoting and conducting responsible lending and managing its financial statements. The diversification and growth opportunities provided by the cooperative nature of credit unions provide a sustainable future the industry and members of credit unions.

The following outlines some risk-weights concerns under the Proposed Rule that require additional attention and re-evaluation.

- Treatment of Mutual Fund Investments

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 credit unions directly. For instance, a credit union that holds "U.S. Treasuries and Government Securities" would assign a risk-weight of 0% to such holdings. In contrast, an investment mutual fund, with similar U.S. Treasuries and Government Securities, would have a risk- weight of 20% assigned to this asset. This disparity in the treatment of the same asset when held by two different entities unnecessarily discriminates against a credit union's investments in mutual funds by penalizing the credit union 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. Mutual funds provide daily redemption at net asset value and generally provide sold share proceeds to the investor on the next business day.

The NCUA should revise the RBC regulation so that mutual fund risk-weights are consistent with the risk-weights on the underlying instruments. 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% and 20% based upon the actual risk ratio of their holdings.

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 credit unions employing the full look-through approach for their analysis of investment fund assets.

- Credit Union Service Organizations (CUSO)

The Proposed Rule risk-weights an unconsolidated investment in CUSO at 150%. The comparison of such a credit union investment to Other Agencies investments is not justifiable. I recommend a maximum 100% risk weight to an investment in CUSO is recommended. This would be consistent with the risk weight assigned to loans to CUSOs.

- Real Estate Loans

The Proposed Rule risk-weights the entire real estate portfolio with consideration of concentration risk of the portfolio to total assets of the credit union. The Proposed Rule does not consider the types of real estate loans within a credit union's portfolio. For example, a credit union's real estate portfolio's adjustable rate loans and/or shorter term loans, such as 10-year fixed rate loans, have far less risks than the portfolios' 30-year fixed rate loans. The Call Report currently has information disclosed at some level of detail for a credit union's real estate portfolio. Therefore, the NCUA should further segment a credit union's real estate portfolio to then risk-weight the varying risks within a credit union's real estate portfolio.

- NCUSIF Deposit

The credit union system has capitalized its own separate insurance fund years ago. This structure and its current value should not be overlooked. The 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. This amount is fully refundable should a credit union convert to private insurance (where allowed), or convert its structure to a bank. This balance is considered an asset in accordance with Generally Accepted Accounting Standards. The NCUSIF deposit should be included in the RBC calculation.

- Mortgage Servicing Assets (MSA)

The revised Proposed Rule did not change MSA's risk weight of 250%. The NCUA should decrease the risk-weight of such an asset as such a high weight does not accurately reflect the risk to capital of a credit union. Additionally, the NCUA should consider the two alternative methods of carrying MSA under generally accepted accounting principles. A credit union is allowed to account for MSA at fair value or at the lower of cost or market. Using either methodology, the maximum value would be reflected as the market value. In either situation, any reduction in market value or impairment would be reflected as an earnings adjustment, to reflect any deterioration in value.

- Off-Balance Sheet Activities

The Proposed Rule creates a competitive disadvantage for credit unions in relation to banks for off-balance sheet activities, particularly unfunded consumer loans. While the NCUA recognized the disparity in the original Proposed Rule and reduced some of the risk-weights for unfunded consumer loans, additional reduction within the final RBC regulations to the credit conversion factor and risk-weights are necessary. The arbitrary credit conversion factor of 10% for unfunded consumer loans is too high.

When considering unfunded unsecured consumer loans under the Proposed Rule, as of December 31, 2014, the industry's RBC ratio would decrease by about 0.11% by simply considering such available unfunded balances. The NCUA should reevaluate off-balance sheet activates to ensure credit unions are not at a disadvantage in the marketplace.

➢ Subordinated Tranche of Any Investment

The NCUA states "credit unions must be able to demonstrate a comprehensive understanding of any investment, particularly an understanding of the features of an asset-backed investment that would materially affect its performance" although still does not define comprehensive understanding. It is unclear as to how a comprehensive understanding would be recognized and consistently applied throughout the NCUA and its regions. I believe the NCUA should provide reasoned judgment of this risk-weight as well as its consistent application by examiners.

In closing, thank you once again for this opportunity to comment on the revised Risk-Based Capital Proposed Rule. I look forward to additional communication related to improving the effectiveness of capital adequacy for credit unions.

Sincerely,

Laurie M. LaChapelle

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