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April 27, 2015

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

Subject: Comments on Proposed Rule: PCA-Risk-Based Capital ("RBC2")

Dear Mr. Poliquin:

I appreciate the opportunity to comment on the National Credit Union Administration's (NCUA) second proposed rule to establish risk-based capital requirements for federally-insured credit unions. I have attached my comment letter from the original proposal for your reference. While I agree with the concept of a risk based capital approach, there remain several flaws in the proposed rule that should be addressed.

Interest Rate Risk

I applaud the removal of interest rate risk (IRR) as a consideration factor. I believe the examples I included in my first response clearly illustrated the serious flaws in the first proposal. The NCUA has asked for comments regarding how they might address interest rate risk in the future.

The current rule that took effect in 2012 along with the examination process is more than sufficient to address any concerns with individual credit union's management of IRR. The modeling and management of IRR involves far too many variables and as each credit union has unique aspects to these variables; any attempt to distill these down to generalizations would in my mind result in a regulation as equally flawed as the interest rate risk portion of the original proposal. It seems a far better and more reliable practice for credit unions to continue to operate under existing rules and to allow the examination process to work so we can have conversations with our examiners regarding our unique balance sheet and our approach to interest rate risk management. We simply cannot paint assets such as mortgage backed assets with the same brush and have examiners hands tied regarding their exam findings because of a flawed interest rate risk regulation. For example, a credit union with a mature portfolio of 10 year mortgages should not be treated the same as a credit union with a portfolio of unseasoned thirty year mortgages, regardless of the concentration. As I stated in my original response, many credit unions with established programs in first mortgage products, for example, have higher concentrations and because of this experience, also have a higher level of expertise on staff to underwrite and manage the product. I urge the NCUA not to issue a new IRR regulation and instead allow us to discuss our approach with our examiners and demonstrate our measurement and understanding of our risk during our annual exam so they can clearly understand our unique funding, product mix and risk factors and make a truly informed

decision regarding the management of interest rate risk at our credit union. We have sufficient rules to address IRR.

Comprehensive Written Strategy

The inclusion of the requirement that a credit union must develop a written Capital Adequacy Plan appropriate for their size and complexity is concerning to me. The proposed regulation does not include enough information for credit unions to know what the expectations are nor what consequences might be if an examiner deems the plan does not meet requirements. The NCUA should be much more descriptive as to the expectations and allow credit unions to comment after the expectations and components of the requirement are fully disclosed.

Goodwill

The phase out of goodwill in the risk based capital ratio should be eliminated. Credit unions sometimes need the goodwill of a merging credit union to make a merger viable. The NCUA's goal of protecting the insurance fund is consistent with the current rule of allowing the existing equity to be used without a phase-out clause because it allows for stronger credit unions to absorb weaker credit unions thus making one strong credit union. Without the use of capital from the merged in credit union, larger, financially stronger credit unions may be unable or unwilling to absorb their weaker counterparts and this in turn will expose the insurance fund to more risk.

Risk Weightings

The NCUA made improvements in the risk weights in the second draft of the proposal. However, I remain concerned that the proposed risk weights are in some cases more restrictive than the Basel III requirements for banks. Consistent with my original comments, I feel it would be beneficial for the NCUA to publish its research data and methodology in establishing the risk weights. Credit unions would be better able to understand the rationale behind the risk weights and offer more direct comments that would further benefit the final rule.

I am also concerned with the use of concentration risk escalators for certain categories. Consistent with my first response, I believe the NCUA should publish its research data to enable credit unions to offer more direct comments.

Thank you for allowing me the opportunity to comment on this proposed regulation. Please contact me directly with any questions or comments regarding this response.

Sincerely,



Mick Olson, CPA
Senior Vice President & Chief Financial Officer
TopLine Federal Credit Union

Enclosure

Cc: Mary Dunn, CUNA
John Wendland, Minnesota Credit Union Network

May 27, 2014

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

Subject: Comments on Proposed Rule: PCA-Risk-Based Capital

Dear Mr. Poliquin:

I appreciate the opportunity to comment on the Proposed Rule: PCA- Risk-Based Capital. While I agree with the concept of a risk based capital approach, I believe there are several flaws in the proposed rule that if not addressed and corrected, will lead to lower capital in the long term for credit unions. Lower capital will result from such actions as credit unions migrating to U.S. Treasuries due to the onerous weights placed on other types of investments that in fact have a better risk/reward profile than Treasuries. In addition, credit unions may avoid profitable loan products in order to manage the credit unions risk based capital because products with different risk profiles are grouped and weighted together. They may avoid some real estate loan concentrations that are weighted the same as delinquent credit card loans, for example.

The implementation period should be extended to allow credit unions time to adhere to the new rules in a reasonable manner. It may take credit unions several years to restructure their balance sheets to fit with the new rules. If the deadline is not extended, credit unions may be forced to make poor economic decisions such as liquidating long-term asset positions at unfavorable economic costs simply to comply with a regulatory mandate, thus lowering capital. This can be avoided by extending the effective date of the rule.

It would be beneficial for the NCUA to publish its research data and methodology in establishing the risk weights. Credit unions would be better able to understand the rationale behind the risk weights and offer more direct comments that would further benefit the final rule.

The proposed rule assigns risk weightings by asset class. Many of these weights appear to be disproportionate to the inherent risk in the class. My thoughts regarding the assigned weights are detailed below:

- A zero risk rating for cash on hand is appropriate, however, assigning the same zero risk rating to all U.S. Government obligations (full faith and credit) ignores several of the risk types identified in table three. More specifically, by assigning a zero risk rating to treasury bonds the proposed rule is ignoring interest rate, liquidity and market risks. A five year treasury bond has an effective duration of 4.75% when purchased at par and a ten year par treasury bond will lose almost 23% of its market value in an up 300 scenario. That is a significant amount of risk and supports higher than zero weighting.
- If the final rule does assign a zero risk rating to all U.S. Government obligations and those guaranteed by the NCUA then I argue that SBA and GNMA obligations (which hold a full faith and credit guarantee) should be assigned an equal risk rating.
- Cash on deposit at the Federal Reserve Bank should be assigned a 0% risk rating. The Federal Reserve Discount Window is included as a contingent federal liquidity source for use in times of financial emergency and distressed economic circumstances in NCUA's letter 13-CU-10. It should follow that the Federal Reserve is a last line of defense in a liquidity crisis and should receive a zero risk rating.
- The category 3 through category 9 risk levels also contain weights that are disproportionate to the inherent risk involved. The NCUA should carefully review these weights for consistency and at a minimum; compare them to similar weights established by Basel III. I believe it would be instructive to credit unions for the NCUA to publish a detailed analysis of their research and disclose why the NCUA's research differs so widely from the Basel III weights.
- Despite the elevated levels of risk weighting over Basel III, the proposed rule ignores interest rate and credit risk and instead focuses entirely on concentration risk for loans - which may not reflect the true risk in the balance sheet.

There are many examples of inconsistency in this section. For example, the proposed rule weights unsecured credit card loans, new and used auto loans, first mortgage loans over 35% of assets and foreclosed and repossessed assets the same. It is unlikely that a pool of auto loans has the same risk profile as a pool of credit card loans. It is also unlikely that repossessed assets have the same risk profile as first mortgage loans in excess of 35% of assets. Further, category 7 groups delinquent credit card loans with investments having a weighted average life between five and ten years. It is unlikely that delinquent credit card loans have a risk profile anywhere near that of agency bonds - regardless of length. Credit unions using risk based pricing have determined a clear difference in the risk profiles of various product types and the NCUA should do the same.

The NCUA must include a measure of risk that better aligns the weight to the overall risk profile and not limit to a concentration level. Many credit unions

with established programs in first mortgage products, for example, have higher concentrations and because of this experience, also have a higher level of expertise on staff to underwrite and manage the product. Credit unions also differ as to what term of mortgage products they typically add to their portfolio. This can have a substantial impact on the risk profile of a portfolio and is not considered in the proposed rule. The proposed rule does not consider credit measures such as loan to value.

At a minimum, the NCUA should group products with similar maturities and risk profiles and assign risk weights to those groups in line with Basel III levels.

- Category 10 requirement would require credit unions to hold over 130% of the asset in capital. It is unclear why this level of capital would ever be appropriate except as a punitive measure and I find this unnecessary. I also believe this determination would be difficult to reach fairly or accurately and as such the NCUA should remove category 10.

The ability for examiners to require higher capital amounts for individual credit unions is not justified. The capital rule should be uniform for all credit unions.

The NCUA has already placed limits on the percent of business loans to assets. The member business loan risk weights should be more reasonable and consistent with the risk profile of these loans.

In addition to the risk weights and other items examined above, the proposed rule fails to consider the entire balance sheet and the hedge against rising interest rates provided by our deposit base. Credit unions have worked diligently to improve the sophistication and accuracy of ALM models. The NCUA should allow for some benefit from our strong deposit base in the final rule.

Thank you for allowing me the opportunity to comment on this proposed regulation. Please contact me directly with any questions or comments regarding this response.

Sincerely,

A handwritten signature in blue ink that reads "Mick Olson". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Mick Olson, CPA
Senior Vice President & Chief Financial Officer
TopLine Federal Credit Union