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COASTAL federal credit union

April 24, 2015

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

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

Dr. Mr. Poliquin:

Thank you for the opportunity to comment on the second proposed Risk Based Capital regulation.

One of the most troubling elements of the RBC2 proposal is the pervasive implication that credit union capital requirements, and also regulation and supervision, should be modified to be more like those applied to Federal Deposit Insurance Corporation (FDIC) insured institutions. The Federal Credit Union (FCU) Act does indeed require NCUA to establish a risk-based capital system that is comparable to that in place for FDIC insured banks; however, the Act also instructs NCUA to take into account the cooperative character of credit unions.1 In drafting the proposal, the agency appears to have devoted itself to the comparability requirement, while ignoring the cooperative nature of credit unions.

Let begin my applauding the agency for listening to feedback from the credit union movement on RBC1, and making substantive improvements in RBC2. Changes we're particularly appreciative of are:

- Lowering the RBC ratio for Well Capitalized to 10%
- Removing the cap on ALLL balances that are included in RBC
- Lowering the risk weights on insured deposits and balances in the Federal Reserve System to 0%
- Removing the punitive WAL tiers on investment securities
- Lowering the risk weights on CLF Stock and FHLB Stock
- Lowering the risk weights on Share Secured loans
- Lowering the risk weights for Corporate Perpetual Capital
- Moving the implementation date to January 1, 2019

Context and Perspective

It is important to provide some context to our detailed comments on this proposed rule, and provide some perspective on our observations of the proposed rule.

- We fully appreciate that the Dodd-Frank legislation and adoption of Basel III by the international banking regulators has put pressure on all regulators to strengthen capital requirements for banks, many of whom were undercapitalized before the financial crisis began due to inadequate regulatory capital requirements. It would seem that the NCUA feels compelled to increase capital requirements for credit unions as well because of these factors, even though the credit union movement had more than sufficient capital to weather the financial crisis.

- The "financial crisis" was caused by bad practices and actions by the mega-financial institutions around the world. The Dodd-Frank legislation, was in part, intended to deal with those "Too Big To Fail" institutions, and to rein in the risks that they could take. Five (5) years later, those institutions just keep getting bigger and bigger. Unfortunately, the regulatory backlash from banking and credit union regulators, and the CFPB, is creating a new class of community financial institutions that may very well be "Too Small To Succeed." Small community financial institutions (yes, at $2.5 billion in assets, we're still a "small" institution in the financial services world), community banks and credit unions, are in great danger of being unable to serve their communities in the future. This proposed rule will not improve that situation.

- By any measure used, credit unions emerged from the "financial crisis" in much better shape than our banking counterparts. Our historical loan loss ratios, delinquency rates, institutional failure rates, and deposit insurance fund losses (excluding the cost of resolving failed corporate credit unions) are far lower than those same metrics in the banking industry. And aggregate leverage capital ratios, which are over 10%, are relatively unchanged since the beginning of the financial crisis. Our "reward" for this exemplary performance is a proposed rule that is still more punitive than Basel III. Chairman Matz has publicly stated that "Basel III is not for credit unions." But this rule is now more similar to Basel III and there are few if any provisions that reflect the cooperative and safe nature of credit unions.

The Impact on Coastal Federal Credit Union

The effects of RBC1 and RBC2 on Coastal are provided in the following table:

	RBC1 12/31/2013	RBC2 12/31/2014
Assets	$ 2,232,953,658	$ 2,423,054,563
Regulatory Capital	$ 230,129,091	$ 247,833,693
Risk-Weighted Assets	$ 1,601,312,975	$ 1,613,467,791
PCA Net Worth	10.31%	10.23%
Surplus Above Well Cap	3.31%	3.23%
RBC Net Worth	14.17%	15.30%
Surplus Above Well Cap	3.67%	5.30%

As noted, our RBC ratio and surplus increase materially with the changes made, although the largest increase is due to our growth in regulatory capital over that period.

Concerns With RBC 2

We do have a number of substantive concerns with RBC 2 that are provided below:

1. **Risk Weighting of Mortgage Servicing Rights (MSRs)**

   Mortgage Servicing Assets (MSRs) have proposed capital weights of 250%, in line with those required by the FDIC for banks. However, MSRs have very different risk profiles for credit unions than they do for banks.

   While it is true that the FDIC assigned a 250% risk premium to MSRs in its risk-based capital requirements, they did not do so because of the risk of the asset itself. The FDIC was addressing a different risk – the risk of too many MSR assets on the books of too few servicers. They were specifically trying to discourage the mega servicers from accumulating any more servicing.

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The four largest servicers in the US -- Wells Fargo, JP Morgan Chase, Bank of America, and Citicorp, -- at the time the FDIC's RBC rules were written, serviced more than 60% of all mortgages outstanding in the US. The FDIC was addressing the risk of this oligopoly when it established its RBC rules. It was strongly discouraging these mega servicers from accumulating any more MSRs, and trying to make it punitive to hold massive amounts of these assets.

The NCUA should be encouraging credit unions to hold the servicing rights to its members' loans, not discouraging it. A mortgage loan is often the most significant financial commitment a credit union member has, and can be the cornerstone of his or her relationship with his or her credit union. A credit union should want to ensure that it controls the member experience related to that asset, and should not be discouraged by its regulator from doing so. For this reason, we strongly encourage the NCUA to consider lowering the risk weighting on MSRs to 100% or less to more accurately reflect the true risk of this asset to credit unions.

2. **Risk Weighting of Investments in Credit Union Service Organizations (CUSOs)**

Coastal has been very active throughout its history in collaborating with other credit unions through CUSOs. Today, Coastal is the sole or majority owner of three (3) CUSOs, and a minority owner of ten (10) other CUSOs.

Coastal has made cash investments in these CUSOs totaling $3,465,000. Today, the book value of those investments is $9.4 million, reflecting a gain of $6 million. And a number of these CUSOs pay annual dividends. For example, Coastal invested $25,000 in CO-OP Financial Services when we moved our debit and ATM processing business to that company. Today, patronage dividends that were paid in additional equity stand at over $1 million.

Some of these CUSOs enable Coastal to offer services to its members that it would otherwise not be able to provide. These include investment and insurance services, trust services, title insurance policies and real estate brokerage services.

We participate in other CUSOs with other credit unions to help reduce our operating expenses. These include a shared branch network, an indirect auto lending network, a shared internet search company, and two CUSOs formed strictly to allow us to share research and development expenses. These CUSOs save Coastal hundreds of thousands of dollars each year.

Under the NCUA proposal, Investments in CUSOs have a proposed risk weight of 250%. Approval of the proposed risk weight on investments in CUSOs will have a significant and chilling effect to collaboration among credit unions due to the capital charge required. Requiring such a high capital weight would likely decrease innovation, cooperation and increase overall credit union industry costs of doing business.

For these reasons, we recommend that the risk weightings for CUSOs also be held at 100%, in line with other operating assets on a credit union's balance sheet.

3. Treatment of NCUSIF Deposit

The NCUSIF deposit is backed out of both assets and Net Worth in performing the Risk Based Capital calculation. The proposal is written such that it only includes assets that would be available to offset losses given conservatorship. Our understanding is that if a credit union goes through a voluntary liquidation, the deposit is remitted to the credit union for the benefit of the credit union's members. Arguably, given a systemic event that wiped out the insurance fund the proceeds from the deposit would not be available. Given a non-systemic event that only resulted in the liquidation of one or a manageable number of credit unions the deposit would be available. It is our position that given a non-systemic event that did not substantially impair the fund that the asset would be available. Consequently, we also encourage the NCUA to include it in the calculation of Net Worth.

We would propose that the NCUSIF Deposit be risk weighted at 100% and that there be no reduction in capital by the amount of this investment.

4. Treatment of Delinquent Loans

The proposed risk weightings for delinquent loans are consistent with that required for banks under Basel III. We don't object to those weightings.

What we do object to is the differential definition of a delinquent loan. Basel III for banks considers a loan delinquent when it is 90 days past due. The proposed NCUA rule considers a loan delinquent when it is 60 days past due. This will be incredibly punitive to credit unions, that historically have lower delinquency and loan loss rates across all loan categories.

We support the proposed risk weightings for delinquent loans, but propose that the definition of a delinquent loan under the RBC rule be revised to include loans that are delinquent more than 90 days.

5. Junior Real Estate Loans >20%

These loans, such as home equity loans, have the same risk characteristics as other consumer loans. In the worst scenario, they behave as unsecured loans. There is no rational reason that these loans would be risk weighted at 150% when unsecured consumer loans, even at high concentration levels, are weighted at 100%.

6. Supplemental Capital

The NCUA has been supportive of credit union efforts to get Supplemental Capital approved by Congress as a tool to meet PCA capital requirements. Certain credit unions are already permitted by the statutes to raise and consider Supplemental Capital in meeting PCA requirements.

This proposed rule presents a unique opportunity for the NCUA to authorize Supplemental Capital as a tool for meeting the proposed risk-based capital rules. We are unable to find a prohibition in the statutes that would prevent this.

We would propose that the NCUA develop companion rules that would authorize credit unions to issue Supplemental Capital instruments to members that would be counted as capital for purposes of meeting the risk-based capital rules.

7. Proposed Capital Adequacy Plan

The Proposed Capital Adequacy Plan Imposes Systemically Significant Financial Institution Stress Testing Requirements on Well-Capitalized and Significantly Smaller Credit Unions

Credit unions are understandably very concerned about NCUA's proposed additional provisions regarding capital adequacy. Potentially, these provisions could be among the most problematic for credit unions in RBC2 because they would grant examiners considerable latitude to determine whether a credit union needs more capital even if it is well-capitalized according to standard net worth and risk-based capital ratio requirements.

Under RBC2, complex credit unions would be required to develop a capital adequacy plan to assess the sufficiency of their capital on an ongoing basis, and set aside capital that is over and above the 7% net worth and 10% RBC requirements. The credit union's plan, assessment, and amount of additional capital set aside would all be subject to examiner review.

These requirements are not necessary for the vast majority of complex credit unions based on their management, risk profiles, and current levels of capital. If NCUA examiners have concerns regarding the credit unions they supervise, those situations should be addressed on an individual basis and not through rulemaking that would apply universal requirements to all complex credit unions, regardless of how well managed they may be.

In recognition of the unique characteristics of credit unions and their lower risk profile, Congress did not intend for credit unions generally to be subject to higher capital requirements than what the FCU Act directs. We reject the notion that the thresholds for a credit union to be well-capitalized as established by Congress are in any sense "minimum" capital requirements. If Congress had intended that to be the case, it would have described the classification as minimally capitalized. Well-capitalized means well-capitalized, plainly and simply. If a credit union meets the net worth and risk-based capital requirements to be well-capitalized, the sufficiency of its capital should not be an issue in terms of any rule that could require it to hold additional capital to be considered well-capitalized. Even if NCUA had sufficient authority to establish higher capital requirements beyond thresholds that Congress authorized it to implement by regulation, a requirement for even more capital beyond what RBC2 anticipates would be overkill.

In light of these concerns, we strongly oppose the capital adequacy plan requirements in RBC2. Strategic capital planning is very important for credit unions, and each credit union's long-term desired capital ratio will depend on the credit union's own assessment of the risks it faces, and its tolerance for risk. Such a plan, which for many credit unions includes a buffer of additional capital to stay above regulatory requirements, should not be the subject of examination and supervision, and the goals a credit union establishes for its own capital sufficiency should not become targets or standards for review in an examination.

We urge the NCUA to delete the capital adequacy provisions from the RBC2 proposal.

In closing, we appreciate the progress the NCUA has made in improving this proposed rule, and urge you to continue to make changes until we get it "right for credit unions."

Sincerely,

Chuck Purvis

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