April 08, 2014

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

RE: Comments on Proposed Rule: PCA - Risk-Based Capital; RIN 3133-AD77

Dear Gerald Poliquin,

This comment letter represents the views of Credit Union of Southern California (CU SoCal) regarding the National Credit Union Administration's (NCUA) proposed Risk-Based Capital (RBC) rule. CU SoCal has 64,000 members and $780 million in assets. We appreciate the opportunity to provide these comments to the NCUA.

General Observations

CU SoCal respects the complexities associated with drafting the proposed RBC regulation. Additionally, we philosophically agree with the concept of RBC; however, we are concerned about the following:

1. The weightings for balance sheet items are significantly different than those required for banks by the Third Basel Accord (Basel III). The proposed regulation seems to use restrictive percentages from Basel III while ignoring Basel III standards that may be more liberal in other areas.

2. The impact of the RBC weightings could, to some degree, drive many credit unions to a cookie cutter balance sheet, where each credit union has the same percentage of total assets allocated to specific loan types. For example, credit unions would have XX% in auto loans, YY% in mortgage loans, etc. This cookie cutter approach would likely force a high percentage of credit unions into less profitable asset growth (e.g., auto loans as opposed to mortgages) and make it challenging to differentiate themselves from competitors.

3. The credit union industry would require approximately $6.5 - $7.0 billion in additional capital to retain the same buffers that exist today to be considered well capitalized. We do not believe the credit union industry is currently undercapitalized to this extent.

4. The proposed capital levels and weightings will likely hamper merger activity and

discourage healthy, well capitalized credit unions, from engaging in mergers with under capitalized credit unions since, for example, the proposal forces credit unions into less profitable asset growth. Additionally, the exclusion of goodwill from risk-based capital disincentivizes merger activity. Discouraging merger activity prevents healthy industry consolidation, which ultimately lowers the risk to the NCUSIF by combining unhealthy credit unions with stronger ones.

Specific Observations and Recommendations

A. Our greatest concern is that the proposal allows NCUA to establish individual minimum capital requirements that may be greater than the RBC requirement. Additionally, the criteria under which the NCUA could require a higher individual minimum capital requirement is broadly defined. Since the RBC proposal is intended to address most major risk areas, including interest rate, concentration, liquidity and credit risks, we do not believe NCUA should have broad subjective powers to require higher capital levels.

Recommendation: Limit, and specifically define, the circumstances under which NCUA can require a higher individual minimum capital requirement.

B. We strongly believe the proposal does not limit “workarounds” that would allow examiners to essentially require a higher individual minimum capital requirement. Below is an actual example of what would be an examiner “workaround”:

Under the RBC proposal, CU SoCal's RBC ratio at September 30, 2013, as calculated by the NCUA, was 14.49% compared to the 10.50% required to be well-capitalized. This means our RBC ratio was nearly 400 basis points above the well-capitalized requirement. Additionally, all of CU SoCal’s interest rate risk (IRR) metrics, at September 30, 2013, were indicating low or moderate IRR according to the table contained in Chapter 13 of the NCUA Examiner’s Guide. Nonetheless, our NCUA Examiner put in place an IRR requirement that is not contained in the NCUA Examiner’s Guide or any NCUA letter. To address this requirement, we restructured our balance sheet. After restructuring our balance sheet, our RBC ratio was 18.19% at December 31, 2013, or nearly double the 10.50% well-capitalized requirement.

We recognize that at the time the aforementioned IRR restriction was imposed, the RBC proposal had not been issued; however, the above example reflects how the proposal does not limit or prohibit an examiner from a subjective “workaround” that ignores quantitative data and requires a higher level of capital.

Recommendation: Add language to limit or prohibit "workarounds" for well capitalized credit unions that would prevent examiners, or the NCUA Board, from requiring higher levels of capital.

C. The proposal contains an appeals process for credit unions that have been assigned a higher individual minimum capital requirement. In our view, the appeals process does not provide for an independent and disinterested appellate entity. The NCUA would be serving as the examiner, regulator, expert, and the "appealed to" entity.

Recommendation: The final regulation should require that an independent third party mediate any appeal between a credit union and the NCUA when NCUA requires an individual minimum capital requirement beyond the 10.5% level.

D. If the Financial Accounting Standards Board's (FASB) current credit loss proposal is passed, credit unions will be required to significantly increase their allowance for loan and lease losses (ALLL). We believe the proposed RBC rule, which allows an ALLL credit of 1.25% of total risk weighted assets, does not address the significant one-time increase in the ALLL that will result if the FASB proposal is implemented, including the need to allow a greater amount of the ALLL to be included in risk-based capital.

Recommendation: Add language to the proposal that states that the ALLL credit will be increased if the FASB proposal is implemented.

E. If we fund a 1st T.D. real estate loan, and total 1st T.D. real estate loans are equal to or less than 25% of assets, we would be required to assign a 50% risk weighting to these loans, and would have credit risk in the event of a default. If we buy a 4% Fannie Mae mortgage-backed security with no credit risk, and a weighted average life similar to that of our 1st T.D. real estate loans, we would be required to assign a 150% risk weighting to the mortgage-backed security. We do not understand the logic of this type of risk weighting, which causes a lower-risk asset to have a higher risk-weighting.

Recommendation: Amend the weighting system to properly reflect the level of credit risk associated with 1st T.D. loans and agency mortgage-backed securities.

F. Loans made to borrowers with superior credit histories are treated in the same manner as loans made to borrowers with poor credit histories. In the mortgage area, loans made to borrowers with low loan-to-value (LTV) ratios are treated in the same manner as loans made to borrowers with high LTVs.

Recommendation: Expand the proposed regulation to deal with credit and collateral risks.

G. The National Credit Union Share Insurance Fund (NCUSIF) deposit is deducted from risk-based capital (the numerator). The deposit is an asset of the credit union and should not be deducted.

Recommendation: Eliminate the deduction to the numerator for the NCUSIF deposit.

H. The proposed rule calls for an 18-month implementation period for credit unions to become compliant. The new Basel III standards allow banks up to four to five years to comply. Additional time to comply with any final regulation is needed to allow credit unions to adjust their balance sheets in an orderly fashion.

Recommendation: Amend the proposed rule to allow credit unions up to five years from the date of adoption to comply.

Thank you for the opportunity to comment and considering our views on the RBC rule.

Sincerely,

Dave Gunderson
President/CEO
Credit Union of Southern California

cc: CCUL