DAYAIR[SM]
CREDIT UNION
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April 23, 2014

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

Re: NCUA proposed risk based capital requirements

Dear Mr. Poliquin,

Thank you for the opportunity to add to the growing dissent to NCUA's risk based capital (RBC) proposal. On the surface, the concept of risk based capital requirements makes much sense. Requiring credit unions with riskier or more complex operations to maintain higher capital levels than lower-risk credit unions seems somewhat intuitive. But the devil is in the details.

I believe there are numerous problems with this proposal, ranging from broad concerns (i.e. is it really necessary? is NCUA seeking to emulate failed bank capital structures? can the definition of "complex" really be reduced to asset size? etc.) to problems with the specifics (i.e. is there any correlation at all between the proposed risk requirements and actual levels of risk? how many examples can be found where the proposed risk requirements simply defy logic? etc.). I'd like to address just some of the more egregious potential effects of this flawed RBC proposal.

ANPR – This proposal is wide ranging and if enacted will result in many adverse unintended consequences. Why was no Advanced Notice of Proposed Rulemaking (ANPR) issued? The ensuing dialogue regarding the concept and effect of any RBC proposal should occur prior to NCUA driving a stake in the ground and issuing its proposed regulation.

State's Rights – NCUA is required to consult and seek to work cooperatively with State officials having jurisdiction over State-chartered credit unions. There has been no evidence of any dialogue with state regulators.

"Complex" defined – The proposal will apply to "complex" credit unions, defined as those with assets over $50 million. Many credit unions above that asset level operate relatively simplistically while many smaller credit unions either operate in a more complex manner or present as great a risk as any other to the deposit insurance fund (i.e. Taupa Lithuanian CU).

Banks are moving away from risk based capital – Banks have been subject to RBC requirements for almost 25 years. They generally did not fare very well in the 2008 recession. Credit unions generally did fare well through that recession, continuing to provide credit while the banks stopped lending. Rather than regulating credit unions in a more bank-like manner, NCUA should seek to preserve the unique differences inherent in our industry. Specifically, NCUA should not propose more stringent RBC requirements than banks which may lead to charter conversions of credit unions to banks.

Proposal is onerous compared to banks – This proposal is more onerous compared to the RBC requirements faced by for-profit banks in Basel III. Given that credit unions have generally performed much better than banks and have specifically managed risk in the business lending area better than banks, it is unreasonable for MBLs, as one example, to be risk rated at higher levels than is comparable for banks. Our RBC requirements, like all other credit unions I'm aware of, are higher under this proposal than under Basel III requirements. What justification does NCUA have to require higher capital standards for credit unions than required for community banks?

Interest rate risk – Interest rate risk inherently cannot be incorporated into a risk based capital structure. Adjustable and amortizing securities carry far less interest rate risk than fixed rate and non-amortizing instruments. Merely comparing the maturities of various securities cannot be a valid indicator of interest rate risk. The same can be said of how mortgages are treated in the proposal. Determination of interest rate risk from call report numbers will provide inaccurate or misleading results.

Treatment of NCUSIF deposit – The deposit to the National Credit Union Share Insurance Fund (NCUSIF) each credit union carries as an asset is completely eliminated from the proposed RBC proposal. This proposed treatment implies that NCUA recognizes an implicit devaluation of the asset. This treatment begs the question: Does NCUA consider that credit union asset to belong to NCUA?

CUSO Investments – CUSOs have allowed credit unions to aggregate and provide cooperative-based solutions in many areas. This proposal which risk weights CUSO investments at 250% will retard growth of CUSOs, which has demonstrably been positive for the industry. Loss exposure to credit unions is limited to the amount invested or lent to CUSOs by definition. Further, while an initial investment in a CUSO may be deemed somewhat risky, typically a successful CUSO will result in growth of that investment amount carried on a credit union's balance sheet. For the growth of that investment in a successful and profitable CUSO to be risk weighted at 250% is absurd.

Mortgage servicing rights – Weighting servicing rights at 250% would have the effect of penalizing credit unions wishing to retain a relationship with members whose mortgage loans are sold. If properly valued, servicing rights have minimal risk.

Implementation period – The proposed 18 month implementation period for such a significant proposal is unreasonably short.

Examiner discretion – The proposal includes that NCUA can impose additional capital requirements on individual credit unions if the Agency raises additional supervisory concerns. This is perhaps the most egregious aspect of a very egregious proposal. Giving individual examiners the power to subject a credit union to different standards than all others is simply unacceptable.

Supplemental capital – While statutory constraints will not allow supplemental capital to be included in net worth or considered Tier 1 capital, supplemental capital should be included in any RBC regulation that is adopted. NCUA should push the envelope for credit unions to have as much ability to raise capital as possible given those statutory constraints. Providing additional avenues for credit unions to raise capital should be an all-encompassing objective for the industry's regulator/deposit insurer.

Regarding a deeper dive into specifics of how the proposal defies logic, the following examples speak for themselves.

1. Residential 30 year fixed rate first mortgage loans risk weight of 50% vs. government agency 30 year mortgage backed security risk weight of 150%. The security carries no credit risk and has similar, and probably less, interest rate risk characteristics than the mortgage loan, but is risk weighted three times higher by this proposal. This defies logic.
2. A Treasury security with average life greater than five years has a risk weight of 0% while an agency mortgage backed security with the same average life is risk weighted 150%. Agency securities had implicit backing of the US government prior to the financial crisis of 2008 and now are explicitly backed by the full faith and credit of the US government. Such a disparate difference in risk weighting defies logic.
3. Unsecured credit card loans are risk weighted at 75%. Given the considerable credit risk in such a portfolio, such a low risk weighting compared to practically credit-risk free agency securities defies logic.
4. An 84 month indirect auto loan with a 130% loan to value ratio has a 75% risk weighting. The credit risk is much greater than the aforementioned agency security with a 5.1 year average life, yet requires half the capital in this proposed requirement – which defies logic.
5. An interest only commercial loan with a 7 year balloon has a 100% risk weighting yet an agency bullet security with a 7 year maturity has a 150% risk weighting. There is considerable credit risk in the business loan and no credit risk in the agency security. Again, this defies logic.
6. Investments in CUSOs have a 250% risk weighting while delinquent credit card loans are risk weighted at 150%. For NCUA to consider delinquent loans less risky than a CUSO investment is beyond illogical; it's ludicrous.

Many other examples could be provided that defy logic. The point here is that this proposal attempts to quantify in a single risk based system many individual risks that simply cannot be calculated in such a manner.

Day Air Credit Union supports the overall objective of ensuring that individual credit unions are well-capitalized; and recognizes that currently the overwhelming majority of all credit unions are either well-capitalized or adequately-capitalized. This proposal is over-reaching and unnecessary. Now is not the time for even more unnecessary regulatory burden that would further restrict the abilities of credit unions to grow and add market share.

This proposal is fatally flawed and should be withdrawn. Rationale supporting the need for such a far-reaching and bank-like proposal should be provided. The factual basis for the risk weightings proposed should be provided. Finally, the industry must be allowed the opportunity to comment on that data and participate fully in dialogue regarding something as important as RBC standards.

Thank you for the opportunity to comment on this proposal.

Sincerely,

William J. Burke
President/CEO