CONSUMERS
CREDIT UNION
Your life. Our commitment.

877.ASK.CCCU (275.2228) • www.myconsumers.org

April 16, 2014

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

RE: PCA - Risk-Based Capital

Dear Mr. Poliquin:

I want to thank you and the board for giving credit unions the opportunity to comment on the proposed risk based net worth rule. In many respects Consumers Credit Union is in favor of this new regulation however this letter is meant to formalize our complete position on the proposal.

Below please find a list of our positions on the proposed rule:

1. Requiring different levels of net worth based on the risk in the balance sheet is in complete alignment with fundamental financial theory as it relates to capital levels for financial institutions. In fact, globally the banking system is in the third iteration of Basel and we as an industry are finally creating parity with other regulated financial institutions. However, the level of reserves being requested from the regulation is far in excess of Basel 3 yet credit unions fared much better in the most recent recession. If you remove the corporate credit union crisis our loss rates to the share insurance funds were far less than the FDIC. As a result, why would we need more capital if in the Great Recession we have already proven that our industry had adequate capital? **The excess capital will come at a cost to our members and the competitiveness of our industry. Please align the reserve percentages more closely with the Basel 3 standard.**

2. The overnight investment reserve percentage in the proposal does not distinguish between funds at the Federal Reserve versus ones at a corporate credit union. We all know that the Federal Reserve deposits are risk free yet corporate credit union investments are only insured up to $250,000. **From a risk and capital standpoint why would we be required to have the same amount of capital on both the Federal Reserve and Corporate Credit Union investments when the risk profile is vastly different?**

3. The proposed regulation also does not distinguish the accounting for mortgage servicing rights. **Essentially the regulation would require a 250% reserve for mortgage servicing rights whether the credit union accounts for the rights based on market or book value.** Our credit union uses market value and makes an accounting adjustment every quarter based on the market value of the MSR. As a result, our valuation is more accurate compared to a book value determination.

Waukegan 2750 Washington Street, P.O. Box 9119, Waukegan, IL 60079-9119
Mundelein 1210 South Lake Street, P.O. Box 503, Mundelein, IL 60060-0503
Round Lake Beach 2626 North Illinois Route 83, Round Lake Beach, IL 60073
Gurnee 4946 Grand Avenue, Gurnee, IL 60031
North Waukegan 3737 N. Lewis Avenue, Waukegan, IL 60087
Volo 195 E. Rte. 120, Volo, IL 60073

Why would we have to reserve the same percentage as a credit union that has a fundamentally inaccurate valuation? **We believe the regulation must differentiate between the two different accounting approaches relating to Mortgage Servicing Rights.**

4. An area of great concern is the reserve percentage tied to investments. We all know the limitations federal and state chartered credit unions have in terms of investments. Essentially, most credit union investments are 100% guaranteed by the federal government with the major exception being corporate credit unions. **From our perspective the rule should separate the reserve requirements of credit risk free investments from those where the funds are at risk.** We all know that thousands of credit unions would have failed during the corporate credit union crisis if it wasn't for NCUA's wisdom to create a rescue plan. **How is it that this rule does not take into consideration the most recent crisis and ensure credit unions account for their investments based on the level of credit risk?** This is a major shortfall in the proposed regulation.

5. Our next comment also is related to the investment reserve requirement. NCUA is taking the approach of the longer the term of the investment the higher the reserve percentage. In fact, investments with a weighted average life greater than one year would have a reserve percentage of 50-200% versus Basel 3 at only 20%. This excessive reserve requirement will significantly impact credit unions leaving them in an anti-competitive position and negatively impacting members. How could we have so much more in allocated reserves when most non corporate credit union investments are risk free? **Our belief is that NCUA is trying to address interest rate risk in this section which is fundamentally flawed as explained below.**

6. The recommended reserves on first mortgages is also far above Basel 3 requirements. **When first mortgages are above 25% of assets the reserve increases to 75-100% versus the Basel 3 agreement at 50%.** This additional reserve is excessive and will limit the ability of credit unions to compete with mortgage lenders who are banks. This is occurring at the same time as the possible dissolution of the GSE's leaving credit unions being impacted on two fronts. The most recent financial crisis has a plenty of data to support the quality of credit union mortgage lending versus banks. **Why is it that we need more in reserves than the banks yet our credit risk profile is less? Also, why doesn't the reserve percentage distinguish between variable rate mortgages and fixed mortgages or low LTV mortgages and high LTV mortgages?** Once again, the only logical reason is to capture interest rate risk.

7. **Next, the proposed regulation also requires reserve allocations of 100-150% for second mortgages when Basel 3 only requires 50%. We would agree that second mortgages do need a higher reserve percentage than first mortgages but really the risk lies in the LTV.** If we had a member with a LTV of 90% versus one with 40% the probability of loss is vastly different assuming the same credit characteristics. Why would we ever have the same reserve percentage? **Also, the extra reserve percentage being requested is far above the added risk leaving home equity lending a questionable product line for credit unions.**

In essence we could be driving the business to the banks thereby hurting our members and the American economy.

8. As mentioned above this proposed regulation is targeting interest rate risk evidenced by the investment reserve thresholds and real estate lending. Any ALM expert would tell us that interest rate risk can only be measured when evaluating the impact of changes in interest rates on BOTH sides of the balance sheet. This is an inarguable fact. We believe this is a major flaw in the regulation and must be changed. **It is our belief that the reserve requirement for investments and real estate lending should match the Basel 3 agreement with the exception of corporate credit union investments which produce substantially more credit risk.**

The credit union industry already has more stringent regulations than banks. Please do not exacerbate a problem that already exists. We are dealing with so many non-traditional competitors and this change will significantly hamper our ability to compete.

9. **We do believe the regulation as proposed does not differentiate the credit risk in credit union loan portfolios.** We do understand this data is difficult to obtain but aligning reserves based on loss and delinquency rated could be one way to get at this objective without using loan level data.

10. Our industry has many CUSO's which have pooled resources to obtain better pricing for CUSO members and allowing scale to be created. **Requiring a 250% reserve for a CUSO investment will leave non-CUSO providers of services to a credit union at a competitive advantage.** These large providers often are focused on profit maximization and not the betterment of our industry or our members.

11. **The increase in the MBL reserve percentages based on concentration of 150-200% when the banking industry is at 100% is extreme.** Credit Unions are required to have personal guarantees on most of their business loans when this is an option for the banks. We inherently are more conservative and this will limit our ability to compete yet again.

12. The reserve percentages for delinquent loans are also excessive. The proposed regulation lists 150% for delinquent loans when banks are at 100%. Please realize that banks calculate delinquency at 90 days and credit unions use 60 days. **I am at a loss as to why the percentages are so far above a global standard when our dollar amount due to aging differences will be higher and our allowance for loan loss already has a reserve for our delinquency?**

13. In the end capital is a cushion for when the economy sours or portfolio segments become higher risk. We do believe that capital is important but the most important measure of risk is the ability of management to manage the risk. A highly capitalized credit union could fail due to inadequate risk management. We all know of highly capitalized credit unions who failed in the crisis due to weak management.

CONSUMERS CREDIT UNION
Your life. Our commitment.

877.ASK.CCCU • www.myconsumers.org
(275.2228)

Excess capital is also dangerous as it requires credit unions to generate more profit to maintain a specific capital level. This additional profit could have been given back to the members in terms of better loan and deposit rates. The end result will be slower growth for the industry. This reduction will hamper our ability to create scale leaving us inefficient and mired in a state of slow growth.
Essentially the result will be an inability to invest in an environment where competition is only increasing and the pace of change is accelerating. Please provide a framework for growth and success for our members and all credit unions in the country.

We sincerely appreciate NCUA's initiative in terms of risk based capital and agree with the importance for our industry. However, it is our belief that the agency has taken an extremely conservative approach which will be damaging for our ability to compete. The industry is at an inflection point and we can't thrive with the current proposal.

Sincerely

Sean Rathjen
President & CEO

cc: Board of Directors

SMR/ hl