

TO: Mr. Gerard Poliquin  
Secretary to the NCUA Board

FROM: Executive Vice President Anthony Grigos  
Assistant Vice President Mark D. Entin  
Bay Ridge Federal Credit Union  
Charter #00078

SUBJECT: Commentary on New Risk Based Capital Computation

DATE: March 12<sup>th</sup>, 2014

Tony, the following will provide you with a response to the new proposed risk-based capital calculation that is being considered for proposal.

This is from Federal Register Vol. 79, No. 39 in regard to proposed rules for prompt corrective action-risk based capital. The proposed risk-based capital requirements would be more consistent with NCUA's risk based capital measure for corporate credit unions and the regulatory risk based capital measures used by the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve, and Office of the Comptroller of Currency (Other Federal Banking Regulatory Agencies). In addition, the proposed revisions would revise the risk weights for many of NCUA's current asset classification; require higher minimum levels of capital for federally insured natural person credit unions with concentrations of assets in real estate loans, member business loans (MBLs) or higher levels of delinquent loans.

As per the proposed rule dated February 27<sup>th</sup>, 2014, comments must be received on or before May 28<sup>th</sup>, 2014. The Board is proposing to revise and replace NCUA's current PCA rules for federally insured natural person credit unions.

Under proposed NCUA RR 702.102(a)(1), to be classified as well capitalized, a credit union must maintain a net worth ratio of 7 percent or greater and, if a complex credit union, must also have a risk based capital ratio of 10.5% percent or greater. Under proposed NCUA RR 702.102(a)(2), to be classified as adequately capitalized, a credit union must maintain a net worth ratio of 6 percent or greater, and, if a complex credit union, must also have a risk-based capital ratio of 8 percent or greater.

Proposed NCUA RR 702.104 would change the title of current Part 702.104 from "Risk portfolio defined to "Risk based capital measures". Proposed Part 702.104 would entirely replace the requirements for calculating the RBNW requirement for "complex" credit unions under Part 702.104 with a new risk based capital requirement. The proposed risk based capital ratio is designed to enhance sound capital management and help ensure that credit unions maintain adequate levels of loss-absorbing capital going forward, strengthening the stability of the credit union system and ensuring credit unions serve as a source of credit in times of stress.

As per Part 702.106 the current standard calculation of RBNW is calculated based on taking the risk portfolio (as a percent of quarter-end total assets) to be multiplied by risk-weighting.

Proposed Rule 702.104© will provide a different risk weighting system called total risk-weighted assets. NCUA reviewed the Basel accords and both the U.S. and international banking system's existing risk-weight measures. Proposed regulation 702.104© would address concentration risk by assigning higher risk-weights to larger percentages of assets in MBL's and real estate loans.

### **CONCERNS REGARDING NEW PROPOSED NCUA RR 702.(102)(a)(1).**

In the late 1990's, Bay Ridge Federal Credit Union was granted a waiver for the aggregate limit on a credit union's net member business loan balances which is presently the lesser of 1.75 times the credit union's net worth or 12.25%. Based on our sound member business loan underwriting practices, we were afforded a waiver from this part of the member business loan regulation. We have been in the business of granting member business loans for almost 50 years. Credit union management has a keen understanding of member business lending which allows for prudent and sound underwriting practices.

**NCUA RR 723.17** was the guidance to allow us to receive the exception to the aggregate rule. **NCUA RR 723.17©** states credit unions that have a history of primarily making member business loans, meaning that either member business loans comprise at least 25% of the credit union's outstanding loans (as evidenced in any call report filed between January 1995 and September 1998 or any equivalent documentation including financial statements) or member business loans comprise the largest portion of the credit union's loan portfolio.

Bay Ridge Federal Credit underwrites member business loans in a prudent and safe manner. The management team at BRFCU has years of experience and only entertains loans with conservative loan to values, reasonable credit scores and reasonable capacity to repay the debt. Bay Ridge FCU has done well in that it has sustained profitability, growth and strong net worth without endangering the underlying membership in any way.

Under the current NCUA Regulation 702. Bay Ridge FCU has a well-capitalized net worth position of 9.44%. In light of the credit union's share growth, Bay Ridge FCU has sustained its current net worth ratio through consistent profitability and limited share growth. Management is mindful of the impact share growth has on net worth levels and limits growth in a prudent and conservative manner. Under the current NCUA RR 702.103 and 702.104 our risk based net worth requirement based on our current allocation of assets is 7.54%. Therefore, our minimal net worth level to be deemed adequately capitalized is 7.54% versus 6% under Prompt Corrective Action. We have attained a current net worth ratio of 9.44% which exceeds the minimum standard by 190

basis points. Management's goal is to build up net worth to at least 10% while maintaining a well-diversified portfolio of commercial, real estate and consumer loans.

The new proposed NCUA Regulation 702.102(a) would replace current Regulation 702.102(a) and would set forth new minimal capital measures for complex credit unions. Although sections 216(c)(1)(A)(ii), (B)(ii), C(ii) and 216(d) of the NCUA use the term "risk based net worth" with the functionally equivalent term "risk based capital" in the proposed rule would better describe the equity and assets the requirement would measure.

As mentioned before, under the new regulation, Bay Ridge Federal Credit Union would have to obtain a 10.5% "risk based capital ratio" to be well capitalized and an 8% "risk based capital ratio" to be adequately capitalized.

### **CONCERN**

We have a major concern with this new regulation in regards to the allocations and computation of the new risk based capital ratio. Bay Ridge FCU presently possesses an MBL portfolio comprised of taxi medallion loans and commercial real estate loans. Our commercial portfolio amounts to \$96,542,607 or 53.36% of our assets. The portfolio is comprised of conservatively underwritten commercial loans with average LTV's of 50% or less. We have just completed an NCUA review in which the examiners found our underwriting quite acceptable. The new "risk based capital ratio" would risk weight the MBL's greater than 25% of assets at 200%.

Since \$51,897,682 of our MBL's are greater than 25% of assets, they are afforded a 2.00 risk factor in the new "risk based capital" computation. Further, the new risk based capital" calculation inflates total assets by the associated risk factors and thus dilutes the denominator in the computation. In the prior computation, assets were afforded risk factor allocations in the numerator to determine the necessary capital requirements based on the portfolio risk allocations. However, the denominator of total assets did not change. Therefore, there was no dilutive effect in respect to the present computation of risk based net worth.

**Our total assets presently stand at \$180,050,820. Under the "new computation" the denominator changes from total assets to "risk based assets" and thus increases to \$212,725,050. Therefore, the risk based capital position of Bay Ridge FCU under the new regulations would be 7.99% versus our current net worth ratio of 9.44%. By diluting the denominator in terms of changing its definition from total assets to risk based assets, our credit union suffers due to its risk weighting of Member Business Loans greater than 25% of assets. In effect, the new regulation changes our net worth classification from well capitalized to undercapitalized (by 1 basis point).**

**The new regulation in our view is unfair in that it affords a very high risk factor to our very well underwritten commercial loans. Our commercial loans are much safer than other types of loans with lower levels of equity. Since we were already granted a waiver from the aggregate limit under Reg. 723 and concurrently have**

**sustained consistent profitability and net worth growth, we feel affronted by this new regulation that places a potential damper on our strategic business plan to grow the credit union assets with additional commercial and real estate loans fueling the growth.**

**In our view, the new regulation should be modified to allow for varied levels of risk weight percentages based on risk factors of the underlying member business loans. It is unfair for an unsecured business loan to be afforded the same risk factor as a fully collateralized member business loans with a minimal history of default and delinquency. Therefore, to summarize, the historical impairment factors coupled with conservative equity positions supported by loan to value ratios should be utilized in determining an appropriate risk rating for member business loans. We vehemently oppose the presumption that all member business loans should be weighted equally as is the present case. We support a calculation that provides for varied risk weighting based on underlying documentation, historical impairment factors and loan to value ratios. That, in our view, would be a much better gage for determining net worth requirements.**

#### **OTHER CONCERNS**

- 1) Within the proposed regulation, an examiner would have discretion to increase risk based capital requirement for an individual credit union based upon examiner subjective analysis of additional risk. We have a major concern with this segment of the new regulation. In that within the text of this new regulation is a revised calculation of the components of “risk based capital” why would an examiner be allowed to alter the computation based solely on a judgmental subjective analysis. The new regulation will include a statutory definition of the components of “risk based capital”. Why should that be adjusted and what would constitute an adjustment? The present regulation does not allow for “examiner judgment” in determining new worth and risk based net worth.**
- 2) The present regulation includes an alternative risk based net worth calculation whereas this new proposed regulation does not.**
- 3) If a credit union is well capitalized on one of the calculations but not the other, what PCA actions take place?**
- 4) The current one size fits all 7% PCA net worth standard still is required by law. There is no relief. There is only an additional regulatory standard on top of statutory PCA standard.**
- 5) Most credit unions have higher risk based capital ratio under Basel for community banks than NCUA’s risk based capital formula for credit unions.**

- 6) **No credit provided for performance in mortgage loan or MBL asset categories.**
- 7) **As mentioned in the prior paragraphs, risk weighting for mortgage loans and MBL's totally concentration based- no mitigating factor for LTV< credit rating or performance.**
- 8) **As mentioned before, credit unions historically chartered for purposes of making business loans are penalized for concentration risk when, in actuality, their non-MBL portfolio is historically proven to be more at risk.**
- 9) **There is no credit to mortgage or MBL's and even consumer loans. There is no credit if the portfolio is performing through strong underwriting of credit risk.**
- 10) **Examiner discretion is a major flaw, creating a subjective goal line that can change and will be impossible to manage towards by credit union management and boards.**
- 11) **No additional authorities granted credit unions well capitalized.**
- 12) **18 month implementation time table does not allow sufficient time for credit union to adjust balance sheet to effectively comply.**

## **SUMMATION**

The management team of Bay Ridge Federal Credit Union sincerely appreciates the opportunity to provide commentary in regards to this new proposed NCUA Regulation 702.104. The Bay Ridge Federal Credit Union management possesses over fifty years of experience in granting commercial real estate and taxi medallion loans. We grant conservative loans which are collateralized by strong equity positions to cover the risk of potential loss. Our average LTV ratio on our medallion portfolio is 42% and our commercial real estate portfolio consists of borrower's with high levels of net worth and strong collateral positions. We also perform detailed credit and cash flow analysis to support the loans. We have consistently built up net worth through sustained earnings. Under the current regulation, we are well capitalized. We have used the current regulation as our benchmark for gaging our future growth. The new regulation is unfair as it does not differentiate between well underwritten member business loans with strong equity cushions versus unsecured poorly underwritten member business loans. The new regulation utilizes blanket concentration risk as the underlying parameter for risk weighting instead of viable credit risk within the portfolio.

The new proposed regulation would place a major roadblock to our book of business and impede our operations dramatically. Our strategic business plan emphasizes commercial loan growth coupled with real estate and personal loan growth. We have the experience

to make sound business loans in a prudent and safe manner. Although we understand the need for regulatory reform in this area, we believe that the risk weightings should reflect matrices for varied levels of credit risk within member business loan portfolio. A well collateralized member business loan with significant equity has minimal default risk and therefore should be afforded a much lower risk factor than an unsecured member business loan. Concentration risk by itself does not necessarily indicate higher risk within a balance sheet if properly managed and monitored.

**Finally, the new proposed regulation is to be implemented effective December 31<sup>st</sup>, 2015. We would respectfully request more time to build up more capital and revise our strategic plan and budget in order to meet the new capital requirements as we would have to adjust our book of business and underlying budget to meet the demands of the new risk based capital requirements**

Looking forward to hearing back in regard to these commentaries.