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LETTER OF COMMENT PCA—Risk-Based Capital

April 29, 2014

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

Submitted via email: regcomments@ncua.gov

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Clackamas Federal Credit Union appreciates the opportunity to provide comments on the National Credit Union Administration (NCUA) Prompt Corrective Action—Risk-Based Capital proposal.

Clackamas Federal Credit Union (CFCU), Charter #11793, has $263 million in assets and serves over 25,000 members in Clackamas County, Oregon. CFCU has been helping members achieve their financial goals since 1957.

NCUA proposes that the revised risk-based capital requirements would be more consistent with NCUA's risk-based capital measurement for corporate credit unions and the regulatory risk-based capital (RBC) measures used by other Federal Banking Regulatory Agencies. In addition, the proposal would revise the risk-weights for many of NCUA's current asset classifications; 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; and set forth the process for NCUA to require an individual federally insured natural person credit union to hold higher levels of risk-based capital to address unique supervisory concerns raised by NCUA. The proposed revisions would also eliminate several of NCUA's provisions, including provisions relating to regular reserve accounts, risk-mitigation credits, and alternative risk-weights.

While we agree with the idea of the rule, we disagree or have concerns in regards to important parts of it. Requiring credit unions to move more towards a RBC measure makes the industry similar to that of banks. Not necessarily a bad thing in and of itself, however, the level of the weights proposed in the rule do place credit unions at a disadvantage as we move forward, additionally they are not fully supported by the agency.

Comparison with the Banking Guidance:

The banking industry is required to adopt the guidance noted in the Basel Committee on Banking Supervision (BCBS) as outlined in the "Basel III: A global regulatory framework for more resilient banks and banking system" via the rules established by Federal Reserve Board and FDIC.

To begin a comparison, the total RBC requirement is similar between the BCBS guidance and the proposed rule at 10.5 percent, which includes the Conservation Buffer of 2.5 percent but prior to the Countercyclical Buffer Range from 0 – 2.5 percent. However, the conservation buffer is only applicable in periods of high credit growth. It is also important to note, that these limits are not effective until January 1, 2019 and are being phased in starting 2013 with a total minimum capital plus a conservation buffer of 8 percent increasing to 8.625 percent, 9.25 percent, 9.875 percent, and 10.5 percent in 2016, 2017, 2018, and 2019, respectively.

The NCUA proposed RBC rule indicates the requirements of the finalized rule would go into effect approximately 18 months after the publication of said rule. Considering we are in the comment period of the proposed rule, we expect a final rule will be published within the coming 12 – 18 months. This will make the final rule effective somewhere around mid-2017. This does not effectively allow for sufficient time to restructure balance sheets in an orderly manner or sufficient time to increase capital for credit unions that need to do so, especially considering the lack of credit unions' ability to access the markets to generate equity capital. What this may cause is an increased activity of mergers for credit unions that are well-capitalized using the minimum net worth ratio requirement of 7 percent but are not so, using the new rule requirements. This will lead to higher concentration of credit union assets in a smaller number of credit unions making such credit unions more risky from a systemic perspective.

Additionally, the net worth ratio required of banks is lower than the net worth ratio required of credit unions to be well-capitalized by 200 basis points. We are not clear as to why? Banks are subject to the same economy that credit unions are subject to. To allow for an equal playing field with banks, we believe our net worth ratios should be similar, and the implementation time of the RBC final rule should be the same as well. This different treatment in the required net worth ratio creates issues for credit unions. To maintain the net worth ratio above the 7 percent required, credit unions have to take on risk to generate earnings sufficient to offset growth. The argument of managing deposit growth for credit unions with net worth ratios in excess of the minimum well-capitalized levels is not logical; in essence we will be creating an issue out of nothing. If we push deposits out to manage our deposit growth, it could create other risk implications such as reputation risk. At the same time credit unions can simply continue to hold cash and not actually take on undue risk to offset growth simply to maintain a ratio greater than 7 percent. In order to offset the dilutive effect of deposits, we are forced to take on risk in the form of loans and investments, increasing all the risks the rule is attempting to manage.

Our recommendation is to have a lower RBC requirement for credit unions or to allow for a longer implementation period that gradually increases to the final rule requirement. The period would need to be sufficiently longer than that reflected in the BCBS guidance, for the simple fact that credit unions cannot raise capital outside of earnings. Additionally, we recommend reducing the required net worth ratio to a level commensurate with the net worth ratio required of banks to allow for an equal and level playing field. At the same time this will reduce the need to assume undue risk by offsetting the dilutive effects from deposit growth.

Comparison of Risk Weights:

We do not see the need to list the different risk weights for the proposed RBC rule and those of the Basel III rule. It is clear the weights as currently reflected in the RBC proposed rule are more prohibitive. The reason it is more prohibitive is the risk weights are attempting to capture a variety of risks such as credit, liquidity, concentration, and interest rate risk. The Basel III capital requirement rules are directed mainly at credit risk, the BCBS finalized other rules to address liquidity risk, without mixing the two.
Additionally, we are not sure of the math supporting the proposed RBC rule. Are the NCUA's proposed risk weights that are different from the Basel III risk weights supported by adequate calculations or modeling, or are they arbitrary? If they are supported by adequate math, it is important that we see the math and models used. If not, these limits have no support.

Also, the weights are not consistent in the treatment for the risks the rule is attempting to address. Direct obligations of the U.S Government as well as Federally Guaranteed Student Loans have no risk weights assigned to them. If the rule is attempting to address credit risk only this is logical, however, risk weights for other assets must be reduced in order to address only credit risk. If other risks are going to be managed using the risk weights, then direct obligations of the U.S Government and Federally Insured Student Loans must have assigned risk weights to capture both interest rate and liquidity risks associated with these assets but not credit risk.

We recommend reconsidering the risk weights on all the asset classes to allow for similar treatment depending on the risks to be managed by the rule. Preferably, the risk weights would address credit risk only and as such would need to be reduced. The reason is we have other tools in place as well as guidance as reflected in the rules and regulations to monitor, measure, and control interest rate and liquidity risks.

Need for Other Limits?

If the risk weights are not changed to include credit risk only, does that mean we no longer need to have limits to address interest rate, liquidity, or concentration risks? Currently we are using models to conduct simulations to determine the volatility in interest income and economic value based on different rate scenarios. These models are expensive to purchase, maintain, and to generate the assumptions needed to provide the models with so that the measurement is as accurate as possible.

We feel that if concentration, liquidity, and interest rate risks are addressed in the risk weights outlined by the proposed RBC rule then the need to maintain and spend funds on such models is diminished along with having limits in place to manage such risks, considering they are captured by the proposed rule.

We recommend that the need to have interest rate risk models, internally or via a provider, be removed along with other interest rate risk limits such as Net Interest Income and Net Economic Value (NEV) volatility as we will be able to simulate the impact on net worth and RBC using calculators built in house with cheaply and easily accessible data from our core processing system. We could simulate the impact on RBC and net worth by including the type of assets we are looking to assume as well as an expected income from those assets.

Conclusion:

Overall, we do not disagree with the general premise of having such a rule; however, we believe the proposed rule along with the minimum net worth ratio required to be well-capitalized place credit unions at a significant disadvantage relative to banks. We also believe it goes against the philosophy of credit unions serving their members if the need will require allocating funds to lower risk weight areas and holding as much cash as long as possible. Moreover, the risk weights outlined in the proposed rule are attempting to capture more than credit risk. If this is the case, we recommend removing the requirement to have other limits such as concentration, interest rate, and liquidity risks since they are already captured in the risk weights. Additionally, we recommend reducing the net worth ratio to levels commensurate with those of banks. Finally, we recommend the agency publishes the modeling and calculations supporting the risk weights being used so that the industry understands how the agency is generating the proposed risk weights. This will allow for a better discussion of the rule.

We would like to thank you for taking the time to read our letter and to incorporate our concerns and recommendations, as well as those from the rest of the credit union industry, into the final decision.

Respectfully Submitted,

Rani Khouri
VP/CFO
Clackamas Federal Credit Union

cc: Northwest Credit Union Association