UNITY ONE
CREDIT UNION

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I am writing on behalf of Unity One Credit Union, which serves members located in Fort Worth, Texas, St. Paul, Minnesota and Kansas City, Kansas. We have 28,700 members and $215 million in assets. I appreciate the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposed rule, Prompt Corrective Action - Risk-Based Capital.

Unity One Credit Union opposes the rule as proposed for the following reasons:

- There is no compelling need for additional capital requirements.
- The risk weightings in the proposal are poorly calibrated and more stringent than comparable risk-weights under the Basel regime for small banks.
- NCUA should not have the authority to impose higher capital requirements on a case-by-case basis as reflected in the proposal.
- The rule as proposed would result in dire unintended consequences throughout the credit union industry that would impact strategic direction, credit union growth and the ability of credit unions to meet member needs.
- No additional capital requirements should be put in place without first seeking legislative action for alternative or supplemental capital.

No Justification For Additional Capital Requirements

The credit union industry just weathered the worst recession since the Great Depression. The past six years have been among the most challenging in our history and yet the National Credit Union Share Insurance Fund performed very well under the existing Prompt Corrective Action (PCA) rules and net worth standards. As an industry, we have a capital/assets ratio of approximately 11.2%. With relatively few losses to the NCUSIF during what could be argued was the worst economic climate in over 8 decades, there is nothing to suggest that the current net worth standards under PCA need to be strengthened or that credit unions are not adequately capitalized.

The proposed rule just adds another layer of capital regulation on top of the existing rules without truly enhancing safety and soundness. The proposed rules would require credit unions to raise billions in *superfluous* capital in order to maintain the same proportion of capital buffers that they currently have. Raising this amount of additional capital will place a strain on the entire industry and create unintended consequences for credit union members since the only way in which credit unions can raise capital is through net income or retained earnings.

Despite the fact that credit unions performed much better than our banking counterparts during the severe recession, despite the fact that the credit union industry is already well-capitalized and despite the fact that the NCUSIF is very strong, the NCUA is choosing to place even more stringent capital requirements on credit unions. No evidence or data has been provided which indicates that the current PCA net worth standards are inadequate or did not serve the industry well during the toughest period in our history. Why, therefore, seek to place even higher standards and place greater burdens on credit unions at this time? This proposal appears to be a solution seeking a problem.

The Risk Weightings Are Poorly Calibrated and Not Consistent With Basel

The proposal, despite intentions, takes a "one size fits all" approach. It attempts to regulate or eliminate almost all risks and seems to be an attempt to gain even more control over individual credit unions' financial decisions and strategies. Ironically, as credit unions are forced to focus on raising even more capital to meet the higher standards, credit union members will ultimately suffer the consequences in the form of higher loan rates, lower dividend rates and higher fees.

All credit unions are not alike. Mortgage loans, member business loans, long-term investments and CUSO investments are not all high risk assets. Yet, with regard to residential mortgages and member business loans the risk weights would be double the comparable Basel weights under this proposal. . And despite the fact that credit union losses in these two categories is about half the loss rates of community banks, the NCUA is proposing double the weighting for credit unions. These higher risk weightings for mortgage loans and member business loans serve as a disincentive to make these loans and many credit unions would be forced to cut back on mortgages and business loans in order to raise their risk-based capital ratio.

The higher risk weightings increase with higher concentration of residential real estate loans. As of June 2013 NCUA statistics, first mortgages made up 41% of credit union loan portfolios and other real estate loans made up 11.6% - for a combined 53.1% concentration in real estate secured loans for *the entire credit union industry.* This data would indicate that *most* credit unions in the country would be subject to higher capital needs under this proposed rule.

As mentioned, the Basel risk-based weightings have been in place for almost ten years and have been tested, studied and adjusted over time. Unlike Basel which assigns weights almost exclusively on the basis of credit risk, NCUA in this RBC proposal is attempting to manage all risks including interest rate risk and concentration risks. This approach results in much higher risk weightings. This begs the question, where is the large-scale, empirical data that was used to establish these weightings? The banking industry has studied risk-based capital weightings for over 10 years and has tons of data and history to justify their weightings. What justification does NCUA have in imposing even higher risk weightings for loan categories in which credit unions have much lower loss ratios than banks?

As an example, Unity One Credit Union has a large portfolio of real estate loans comprised mostly of second mortgages. This portfolio provides us above market yields, a relatively short weighted average life and a very low loss ratio. We have been making these loans for over ten years and the portfolio is well-managed and has performed admirably. Because of the premium yield we earn on these loans and the shorter duration, this portfolio also presents very little interest rate risk. Yet, the proposed rule would force us to raise additional capital to cover the higher risk weighting arbitrarily assigned to all mortgage loans. High quality residential mortgages should not be charged more than 50% risk weighting regardless of concentration which is consistent with Basel III.

This same arbitrary approach is applied to CUSOs and member business loans under the proposed rule. All CUSOs are not alike and all business loans are not alike, but in the proposed rule NCUA is treating them all as high-risk assets. CUSOs differ by the types of services offered, how long they have been in business, number of investors and by purpose. Historical performance of the CUSO is not accounted for and in many cases the original investments in CUSOs have long since been recouped. Most business loans are fully secured and are underwritten in such a manner to protect against losses. Once again, historical performance is not taken into account. A credit union can have a long-standing, strong-performing portfolio of business loans based on sound underwriting, yet be forced to set aside additional capital strictly because NCUA deems all business loans to be high risk in this proposal.

CUSOs are a great tool for generating non-interest income. In today's economic environment, net interest margin alone will not cover operating expenses for most credit unions. CUSOs provide a resource (owned by credit unions) for reducing operating expenses and/or providing new revenue streams. There are many successful, profitable CUSOs that have been in existence for many years. Yet, in this proposal NCUA is essentially punishing any credit union that invests in a CUSO by imposing a "capital tax" in the form of higher risk weightings. Once again, there is no empirical data or evidence provided by NCUA indicating that investments in CUSOs or member business loans are inherently riskier.

Another aspect of the RBC calculation that should be fixed is the elimination of the NCUSIF deposit from the numerator. This removes a valid asset from the calculation – an asset that must be returned to the credit union in the event the credit union converted to a bank charter. Since each credit union has a valid claim to this deposit, it should be included in the numerator of the calculation.

Finally, as it relates to risk weightings, in this proposal the NCUA is pegging the standard to the well-capitalized level. This appears to exceed the authority given to NCUA in the Federal Credit Union Act. If anything, the standard should be pegged to the adequately capitalized level. NCUA is further required under the Act to take into consideration the unique structure of credit unions when implementing a risk-based net worth rule. However, the risk weightings in the proposed rule are more stringent than the Basel risk-based weightings for small banks. This despite the fact that credit unions have performed better than banks in all of the risk categories and despite the fact that credit unions have limited means to raise additional capital. The structure and performance of credit unions suggest that the risk weights should be *less* stringent than banks.

NCUA Should Not Have the Authority To Require Higher Capital Levels On a Case-By-Case Basis

The proposal as currently written provides examiners the ability to require credit unions on an individual basis to maintain even higher levels of capital than required under the RBC calculation. This is a dangerous clause that empowers the NCUA to essentially ignore the rule in place and set whatever capital standards examiners so choose for each credit union. If a risk-based capital rule is properly calibrated and based on empirical evidence, and if a credit union is meeting the adequately capitalized standard in place, NCUA should not be allowed to change the rules and establish a moving target. This authority must be removed completely from any final rule. Even NCUA board intervention should not be allowed.

The Rule Will Result in Detrimental Unintended Consequences

Despite NCUA's contention that this proposed rule would only impact 199 credit unions, this does not account for asset growth, changing credit union strategic needs and the increased capital costs for credit unions just to maintain current capital cushions.

Quite frankly this proposed rule places all credit unions at a competitive disadvantage and is counterproductive. In order to raise or even maintain capital levels, credit unions will be forced to raise net income (the only method by which credit unions can build net worth). Under the current interest rate environment this is already difficult to do, but then many of the best options for raising income (CUSO investments, member business loans, long-term investments and mortgage loans) are discouraged under this rule. For each mortgage loan, CUSO investment, long-term investment, etc. that is added to the Balance Sheet a "capital tax" is assessed in the form of a higher risk weighting. As a result, credit unions instead will be encouraged to raise fees, lower dividend rates, raise loan rates and cut expenses in an attempt to build capital regardless of the actual risk profile of the credit union. Under this rule, credit unions will be managing toward maintaining superfluous capital levels rather than managing in the best interests of the membership. The focus will be on maximizing net income rather than maximizing returns to the members. This entire approach, which is encouraged under this rule, is contrary to the mission and mandate of the credit union movement. It essentially defeats the purpose of a financial cooperative and removes the advantages of credit union membership.

To maintain cushions above the adequately capitalized level, many credit unions will be forced to completely abandon their business model. Many will be forced to restrict growth or turn away potentially profitable business. Others will be forced to merge. Some very successful "niche" credit unions that focus on assets that are deemed too risky under this proposed rule could very well be forced out of business. The increased need for net income will likely translate into less competitive share and loan products. In an attempt to cut costs, many credit unions will cut back on much needed investments in technology or infrastructure that members demand. The rule is counterproductive by requiring higher levels of earnings to build capital, yet unnecessarily restricting earnings by "taxing" more profitable assets.

The requirement for ever higher capital levels make profits the focus of the industry, rather than meeting the needs of the member/owners. When profits become the focus, we become no different than our for-profit banking counterparts. Regardless of intentions, this rule becomes another method to micro-manage credit unions and to override the board and management's judgment as to what constitutes adequate capital for *their* credit union. There is a danger to the long-term sustainability of credit unions when unnecessary amounts of capital must be set aside in relation to each individual credit union's true Balance Sheet risks.

<u>No Increased Capital Standards Should Be Put In Place Without Alternative Capital</u>

In the current environment, credit unions are struggling to maintain a positive return on assets (ROA). Net interest margins are very thin, operating costs continue to increase (mostly due to the costs of ever-growing regulatory burdens) and fee income continues to be eroded. It is very difficult to raise net income without implementing strategies that ultimately hurt the members – as mentioned above. Unlike banks, we cannot raise capital through the equity markets by issuing stock. Our only means to build net worth is via net income.

Instead of imposing even higher capital standards on the credit union industry (despite the fact that there is no evidence that higher capital levels are needed), the NCUA should instead be seeking legislative action to authorize supplemental capital for credit unions. Without the means to raise supplemental capital, I can assure you that the unintended consequences outlined earlier will begin to play out throughout the industry. If increasing net income becomes the focus in order to chase ever higher levels of net worth, it is inevitable that credit unions will be forced to take drastic actions to chase profits.

<u>Conclusion</u>

In summary, we believe the proposed rule should be completely withdrawn and scrapped. The current PCA leverage ratio has served the industry well and there is no compelling reason to reinvent the wheel. The credit union industry survived the Great Recession quite well even while also writing down corporate credit union investments and building the TCCUSIF. As an industry, we are very well-capitalized and the NCUSIF is very strong. The number of CAMEL 3 & 4 credit unions continues to decline. There is absolutely nothing to indicate that credit unions need to maintain higher net worth levels, yet the NCUA keeps raising the bar for capital requirements without providing additional tools to raise capital.

The statutory capital requirements are already in place. If the NCUA believes an individual credit union is taking on too much risk in any specific area, those risks should be handled during the examination process and in Documents of Resolution. Each individual portfolio of mortgage loans, business loans, CUSO investments, and long-term investments should be analyzed at each credit union to determine their true risk exposure before determining whether additional capital is needed. Don't place higher capital standards on all credit unions for the poor decisions of a few. Don't place higher capital standards on all credit unions without any evidence or empirical data that shows more capital is needed.

We believe that if this rule is implemented as proposed, it will change the focus of all credit unions. It must be understood that building net income comes with a price. Applying a one-size-fits all rule that doesn't take into account the individual differences in credit union business models, membership needs, growth rates, strategic plans and actual performance of the assets being risk-rated, forces all credit unions to operate and manage the credit union with an emphasis on growing net income. Any rule that places an emphasis on building net worth is essentially promoting profits over the best interests of the members. Intentional or not, any rule that encourages credit unions to maximize profits over maximizing returns to members is a bad rule and contrary to the very mission of the credit union movement.

Sincerely,

Gary R. Williams

Gary R. Williams
President / CEO
Unity One Credit Union