US FEDERAL
CREDIT UNION

Date: May 2, 2014

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

Via Electronic Delivery: regcomments@ncua.gov

Re: Prompt Corrective Action – Risk-Based Capital; RIN 3133-AD77

Dear Mr. Poliquin:

On behalf of US Federal Credit Union (USFCU), please accept this response as input to the proposed rule to establish risk-based capital (RBC) requirements for federally-insured credit unions. USFCU is a $960 million credit union serving over 70,000 members in a seven country geographical field of membership surrounding the Minneapolis/St. Paul metropolitan area in Minnesota.

We appreciate the opportunity to comment on this proposal which could have significant impact on our members and the credit union system. While USFCU generally supports a modernized risked-based capital system that is consistent with relevant methods used in the financial industry, we believe the NCUA's proposal is not the right approach for our members specifically nor for the credit union industry in general. We have **two main points**:

1) Risk-based capital rules implemented by BASEL III and other comparable federal banking agencies focus on credit risk while the NCUA's proposal attempts to factor in interest rate risk, concentration risk and liquidity risks. While this approach may seem consistent with one possible interpretation of the statutory requirement for the Agency to address all risk categories, attempting to combine them into one proposal leads to inconsistencies between risk factors. These risk factors all have significant fundamental differences as to cause and effect, and therefore should have their own risk management and mitigation strategies and provisions. It is highly unlikely that the intent of the language in the statute was to have one approach and one universal algorithm applied to all risks in the same fashion.
2) Significant differences between risk-based capital rules produce the unintended consequence of making credit unions significantly less competitive and less able to serve their members' financial needs and to accumulate additional capital at the same time.

1) Addressing multiple risks in one rule leads to inconsistencies:

- The proposed rule excludes Treasury securities from risk weights in an effort to reduce liquidity risk. But investments in 3-5 year Ginnie Mae securities would have higher risk weightings (75%) than investments in zero coupon 30-year Treasury securities (0%). These securities have significantly more interest rate risk which the proposal is also seeking to reduce.
- USFCU could pay Ginnie Mae a guarantee fee to securitize first mortgage whole loans (50% risk weighted) in an effort to lower our credit risk and improve the liquidity of our assets. The result

under the rule would be a higher capital requirement as these new agency securities require a 150% capital risk weighting. This seems somewhat counter-productive.

- Attacking multiple risks by imposing high risk weightings on large concentrations of member business loans and real estate loans while ignoring the terms and quality of these loans can put these risks in conflict with each other. While the risk weightings address concentration risk, a sizable portfolio of variable rate, shorter term and low loan-to-value loans could reduce interest rate risk with acceptable credit risk and improve earnings.
- The rule is attempting to reduce interest rate risk while only considering the asset side of the balance sheet. Depending on the mix of the credit union's balance sheet, the rule could entice credit unions to reduce the duration of their assets and actually increase interest rate risk. Our credit union has substantial amounts of stable core deposits and we have been attracting longer-term certificates to manage our interest rate risk which would not be considered in the proposed rule. The reality of an actively managed balance sheet makes the mix in the balance sheet dynamic which further complicates trying to manage and balance interest rate risks, liquidity risks and credit risks all combined in the same formula.

2) <u>The proposal puts our credit union at a competitive disadvantage to other financial institutions.</u>

Including interest rate risk and concentration risk limitations in the RBC rule makes it punitive for larger credit unions, as they compete with banks that do not have the restrictions and yet maintain access to multiple sources of capital. For example, the rule proposes that a Government Sponsored Entity (GSE) agency bond with a five-year average life be risk weighted at 150%, which is more than seven times the risk weight for banks (20%). In contrast, the proposed risk weight for a credit union auto loan is 25% which is less than for banks. These disparities will dampen our credit union's ability to make money because short duration bonds and auto loans are less profitable than long duration bonds, small business loans and mortgages (if risks are well-managed). This could lead one to think the NCUA believes operating a credit union is far more risky than operating a bank. Surely this is not the kind of message to send to members, communities, and legislators.

Other competitive disadvantages of the rule:

- The requirement to subtract goodwill from net worth when calculating their RBC is inconsistent with BASEL III.
- National Credit Union Share Insurance Fund 1% Deposit is subtracted from capital in the RBC calculation. This implies that the deposit is worthless and should be expensed versus the current accounting method of capitalizing this deposit.
- The Federal Home Loan Bank (FHLB) capital risk weighting is not specifically assigned so it defaults to the "other asset" 100% risk weighting which <u>compares unfavorably to 20% for banks</u>
- In general, risk weightings in the proposed regulation are significantly higher than those for banks for longer duration investments and higher concentrations of real estate loans and business loans.
- The 18-month implementation period is insufficient. By comparison, banks under the most recent version of Basel III, have approximately nine years to plan and implement their regulation. USFCU has strategically regrown our capital buffer through earnings (under difficult economic

conditions) to acceptable levels based on the current regulation. This buffer will be negatively impacted by the proposed rule. We should note that banks have several sources from which to build capital while credit unions have only one – retained earnings! Banks, therefore, have much greater access to capital than USFCU has and much more time to rebuild their capital buffer. This again puts our credit union at a greater disadvantage to banks in our competitive market.

Our credit union currently has a growth strategy; particularly, diversifying our revenue sources by expanding our member business services and potentially expanding further into CUSOs. The proposed RBC rule has a penalizing 250% risk weighting on CUSO's regardless of profitability or capital levels. We fail to see the rationale for such a high risk rating for a CUSO. Unfunded business loan risk weightings (at 75% of the conversion rate) are significantly higher than banks. These competitive disadvantages will make it difficult for USFCU to grow and prosper under the new rules.

Other concerns:

Allowance for Loan and Lease Losses (ALLL) is limited to 1.25% of risk assets.
If this is a recognized reserve, why limit or restrict it in any way? Generally Accepted Accounting Practices (GAAP) won't allow ALLL to be an excessive amount, but the motivation for the RBC system is to maintain a proper and rational capital allowance for the risk of loss. So why limit it? This is of particular concern in light of the Financial Accounting Standards Board's (FASB) proposed "Accounting standards update regarding financial reporting of credit losses on loans and other financial assets held by financial institutions". There has been speculation that credit union's ALLL could increase by 50% -- 100% if this proposal is accepted by FASB; and, as such, credit unions will be negatively impacted under the RBC purposes for complying with GAAP.

USFCU is opposed to the proposed rule's allowance for imposing additional capital requirement on a case-by-case basis.
This provision is too vague, too subjective, unreliable and unpredictable. We object to the notion that a well or adequately capitalized credit union might fall subject to additional capital requirements, regardless of its ability to strategically manage its classification through objective measures, because the NCUA may have a different opinion on a credit union's decision to have certain concentrations in assets or invest in higher risk-weighted assets or investments. Besides, the NCUA already has broad authority under "safety and soundness' to address any broader issues outside of this rule. There are better ways for the Agency to address the riskier operations of "outlier" credit unions.

Finally
Overall, the RBC proposed rule goes too far in its efforts to curb several areas of industry risk resulting in a punitive system instead of providing USFCU and other credit unions with opportunities for healthy growth and success.

While there are often inferences that the RBC rule for credit unions "must be comparable" to that of other financial institutions, we feel that "comparable" does not mean "the very same as". The Oxford English Dictionary defines "comparable" as "having **similar** aspects". We also note that there are instances in which the risk ratings and capital requirements proposed for credit unions far exceed those of the banks, which seems to be at odds with the concepts of *comparable* or *similar to*.

Thank you for this opportunity to share our thoughts and concerns on the proposed RBC rule and to provide input for the Agency's consideration as the final rule is prepared.

Respectfully,

Bill Raker
President/CEO
US Federal Credit Union

Leon H. Eichten

Leon Eichten
Senior Vice President/CFO
US Federal Credit Union

cc: U.S. Senator Al Franken (MN)
U.S. Senator Amy Klobuchar (MN)
U.S. Representative John Kline (MN)
Credit Union National Association (CUNA)
Minnesota Credit Union Network (MNCUN)