MARSHFIELD
MEDICAL CENTER
CREDIT UNION

May 5, 2014

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

RE. Risk Based Capital Proposal

Dear Mr. Poliquin,

Thank you for the opportunity to comment on the proposed Risk Based Capital Rule. I believe this rule is deeply flawed and, if approved as drafted, will have a negative impact on my credit union and on the entire credit union industry. I fear for the industry but have taken heart by reading the comment letters written by numerous other credit unions stating their concerns. I commend the credit unions for commenting and expect you will receive more letters before the comment period ends. However, I believe many credit unions with high net worth levels will believe this rule does not impact them – but it will eventually because it attempts to homogenize the industry and will restrain growth opportunities, limit services to members, reduce the value proposition of credit union membership, and diminish the role of the credit union board of directors.

For background, please note that I manage a closed charter credit union that will fall to “adequately capitalized” from “well capitalized” primarily because of investment durations. While making loans to members is a priority for us, in the past decade we have seen more growth in deposits and strategically decided to build an investment portfolio containing US Agency securities, GSE securities and FDIC insured CDs – extremely safe from a credit risk perspective. The portfolio is a mix of adjustable rate and fixed rate securities, amortizing instruments, and bullet instruments. The proposed rule seems to focus on interest rate risk based on an instrument’s duration. Unfortunately, it does so without consideration of attributes like adjustable rates and amortizing features that carry less interest rate risk. I get that NCUA is fixated on interest rate risk in this historically low rate environment. What I don’t get is that NCUA has drafted a rule that so poorly addresses interest rate risk by using one metric, one side of the balance sheet, and one interest rate environment. The FDIC approach for small community banks in developing their risk based capital rule is very different. They acknowledged measuring interest rate risk with a static calculation was not practical or beneficial as bank management should be following appropriate asset/liability processes as determined by the structure of their *entire* balance sheets. Only credit risk is included in their rule. The NCUA proposed rule punishes us for serving all members (savers and borrowers) without regard to our mission and market.

I have additional concerns as follows:

Individual Minimum Capital Requirement (IMCR)

This component of the rule is extremely troubling. Why create a rule if subjective expertise can override a credit union's compliance with the formula? This credit union has intentionally managed to a small buffer over well capitalized because of a history of low loan losses we have due to our closed charter member base. I hear "you're not at peer for net worth" from examiners all the time. Well, we have been better than peer for delinquency and loan losses for decades but I can envision an automatic IMCR to be equal to the peer for RBC. At the very least, this part of the rule should be rewritten to define exactly the circumstances that would apply and should not be the judgment of one person and should have a fair appeals process. Preferably, it should be eliminated from the final rule as NCUA already has ample methods to address problems in credit unions. One could ascertain from reading the recommendations and suggestions regarding losses to the NCUSIF contained in the Material Loss Reviews (MLRs) for natural person credit unions prepared by the NCUA Office of the Inspector General are NCUA's reasoning for this component in the proposed rule. However, in reading the MLRs it becomes apparent credit risk and fraud were the primary reasons for the losses. No amount of capital will solve poor underwriting, mismanagement (criminal or incompetent), or strategic overreach (i.e. massive increase in certain loan programs).

Definition of a Complex Credit Union

Asset size as the sole determining factor for a credit union to be complex is too simplistic. There should be other considerations included. I would argue crossing an arbitrary threshold in asset size is not indicative of complexity, but, rather the balance sheet structure is the determining factor. Permissible activities including real estate lending, member business loans and investments authorized under regulation reside on many credit union balance sheets (as they should). An assumption that these become riskier as a credit union grows is incorrect.

Implementation Time

Eighteen months is not enough time to change strategic plans and restructure balance sheets. A recommendation would be to phase in over a one to four year period. For example, if the final rule is enacted this year then at end of 2015- well capitalized should be 9.00%, at end of 2016- well capitalized should be 9.50%, at end of 2017- well capitalized should be 10.00%, and at end of 2018- well capitalized is 10.50% and higher. The other capital status categories should be aligned in a similar fashion.

Risk Weightings

The risk weightings are a problem. There are many credit union comments noting competitive disadvantage in real estate lending due to the rule trying to capture many types of risk but falling short of that objective and I agree with them. Some have commented their business model is impacted because of their concentrations in member business loans (MBLs) and while I do not have experience in this area I am concerned about the attempt to homogenize the industry. Credit unions were formed *by the members for their members.* Other risk weighting categories do not make sense. As mentioned previously, increasing risk weights (50% to 200%) for very safe investment instruments based on weighted average life (WAL) as compared to the banking approach

(20% for all durations) is a major concern. Amortizing instruments versus bullet instruments and fixed rate versus variable rate instruments require different treatment. A recommendation is to add a duration bucket in the five to ten year category (i.e. five to seven and seven to ten) because an investment instrument with a 62 month weighted average life (WAL) carries far less interest rate risk then an instrument with a 119 month WAL. Additionally, credit unions need to know the rationale behind the factors to understand what types of risks are being addressed.

Elimination of NCUSIF Deposit

My issue with the elimination of the NCUSIF deposit in the denominator and numerator is that NCUA noted that bank's don't have this so it's been taken out of the formula to be more comparable to the BASEL III standards. What? The NCUA approach to include measuring more than credit risk already destroys any true comparability to the FDIC (BASEL III). And, who is this rule written for? Doesn't NCUA understand the industry they regulate? It's an asset under GAAP so I believe it should not be taken out of the formula but could be risk weighted within reason.

Other Concerns and Conclusion

There are several other components of the proposed rule that I do not agree with. They include measuring delinquency at 60 days for credit unions versus 90 days for banks, the treatment of delinquent federally-guaranteed student loans, limiting the ALLL credit in the calculation, and the risk weightings for CUSO and corporate credit union investments.

In conclusion, while I appreciate the difficulty NCUA faces in crafting a rule of this importance, significant revision is necessary to the proposed rule to mitigate unintended consequences. As drafted, there is the potential for some credit unions to pursue charter alternatives or mergers to the detriment of our industry.

Sincerely,

Carol J. Adler

Carol J. Adler
President
cc: The Honorable Sean Duffy, Wisconsin 7th Congressional District
The Honorable Ron Johnson, U.S. Senator for Wisconsin
The Honorable Tammy Baldwin, U.S. Senator for Wisconsin