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Mr. Gerard Poliquin
Secretary, NCUA Board
1775 Duke Street
Alexandria, Va. 22314-3428

May 2, 2014

Ref: NCUA Risk-Based Capital Proposed Regulation

We are writing on behalf of GTE Financial and would like to provide the following comments on NCUA Risk-Based Capital Proposed Regulation (RBC). GTE Financial has been serving West Central Florida since 1935, and we are a designated low-income credit union with over 216,000 members and $1.692 billion in assets.

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Under this proposal, GTE's Net Worth Ratio stays at "Well Capitalized", however, using the RBC measurement, we would shift from being "Well Capitalized" to "Adequately Capitalized", with the primary drivers impacting RBC classification being member business loans, mortgage loans, mortgage servicing rights, and CUSO investments.

GTE strongly disagrees with the proposal as it is written. GTE believes the current leverage ratio (7% for well capitalized) provides ample equity for future losses, as this measurement applies to all assets. In addition to the leverage ratio, credit loss exposure is accounted for separately in the Allowance for Loan Loss Account.

NCUA indicates in its RBC proposal that its primary goals are to address the weakness in the current leverage ratio, address 6-risks categories, and provide stability to the credit union system while relying on data already collected in the current Call Report structure.

We will comment on the specifics of the RBC proposal as it is compiled today, describing why we are not in favor of certain provisions.

## Exclusions

The current proposal specifically excludes all credit unions with less than $50 million in assets from compliance with RBC. It is our belief that this is based on the premise that small credit unions mostly serve low- and moderate-income members, and subjecting them to the provisions of the RBC would have an adverse effect on their ability to serve those members. We strongly recommend that all credit unions designated as low-income and who have secured their CDFI designation also be excluded. That would allow these credit unions to fulfill their expanded mission and leverage grants, risk-based lending, and other prudent programs that provide needed financial services to this segment of members.

## Risk-Weights

GTE does not agree with the risk weights and believes they are too high, do not segment the pools of assets sufficiently, and will require excessive capital accumulation from our members.

The 6-risks categories proposed attempts to address the issues by forcing each into this single formula which appears to be the reason for such high risk weights. This one-size fits all approach is excessive and a major growth inhibitor as it will lead to higher fees, higher loan rates, reduced return on members' deposits, less flexibility in the lending risk model, and fewer service options.

## Data Collection

A limited and outdated agency reporting system (5300 Call Report) needs to be updated if NCUA is going to attempt such a major, long-term overhaul of every natural person credit unions' balance sheet. NCUA's goal of relying on this system to minimize recordkeeping is not the right path to take. Both the NCUA and the credit unions it insures and regulates have a long history of being innovative and should be able to use technology to make difficult things simple. Please take action here. Let's not amplify capital requirements because we want "simple" in the reporting process.

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## Model

Although corporate credit unions and banks have similarities in assets, they do not operate under the same economic models or motivations of natural person credit unions. GTE is a designated low-income credit union serving the needs of people of low and modest means. For this type of change to be effective, it should be aligned to natural person credit unions such as GTE, considering the overall impact to our members and their ability to have an alternative to banks for their financial needs.

If this proposal is designed to be objective and one-size fits all, how can the NCUA incorporate a provision which allows a single examiner to override any component of the RBC measurement on a subjective basis by allowing them to apply their own individual minimum capital standards? This represents a no vote of confidence on the entire proposal by the agency. This subjective provision of individual capital needs to be removed.

## Implementation Period

NCUA has also proposed an 18-month implementation deadline. This amount of time is insufficient and heightens the risk of recognizing or causing losses by influencing (forcing) credit unions to unnaturally calibrate their balance sheets by selling off assets that would naturally payoff over their agreed upon contractual time lines. If it is NCUA's wish to have capital requirements more consistent with banking regulatory measures, there should be equal time allotted to credit unions as there was for banks under BASEL capital standards. NCUA should allow up to 5 years for the implementation time frame and have transitional markers over this period of time.

## NCSUIF Deposit

When Congress passed the Credit Union Member Access Act they determined that a higher capital ratio of 6% (this exceeds the 4% Tier 1 leverage ratio applicable to banks) was appropriate because credit unions cannot quickly issue capital stock to raise their net worth as soon as a financial need arises. Instead, credit unions must rely solely on retained earnings to build net worth, which takes time. For this reason, Congress established a capital level two percentage points higher than banks' Tier 1 capital, with 1% of a credit union's capital dedicated to the NCUSIF and another 1% of a typical credit union's capital dedicated to its corporate credit union.

With that said, NCUA is ignoring the 1% component already contemplated in the 6% statutory capital requirement for the NCUSIF and also deducting it again by eliminating the NCUSIF deposit from the numerator. The result of this proposal is requiring credit unions to accumulate 2 percentage points in capital and no credit (or justification) for this move.

## Allowance for Loan Losses

NCUA states in its proposal that limiting the ALLL to 1.25% of assets will provide an incentive for credit unions to grant quality loans and record loan losses in a timely manner. We are not sure how this is an incentive since it implies credit unions are making faulty loans from the start and should red-line areas or withhold credit from individuals who may have some credit disadvantages. In our opinion this would violate the Fair Lending Act – is the NCUA asking credit unions to violate this law? GTE's mortgage loans are made to members, who after the fact, became financially stressed just as did most of the country during the Great Recession. Limiting ALLL to 1.25% does not account for areas of the country which are under judicial foreclosure rules. These foreclosures are taking in the neighborhood of 4 to 5 years to work themselves through the court system. GAAP requires the impairment be carried in the ALLL until the asset is in possession. As of 12/31/13, GTE has an ALLL/Asset Ratio of 1.48%, of which 36% is for loans in the process of foreclosure. Under this proposal, GTE would not be able to count $3.8M in ALLL – none of which has to do with credit union management making timely recording of losses. This limitation needs to be removed completely.

## Goodwill

Goodwill should not be excluded from the calculation of the RBC numerator. Goodwill is accumulated on a credit union's balance sheet because there was value in a transaction (merger) which NCUA must have approved. Healthy credit union mergers should be promoted; by excluding Goodwill, NCUA is promoting credit unions to change charters to mutual savings or convert to banks in order for the net economic value of a credit union to be recognized. This is prejudicial to the industry and its members. NCUA need not hinder credit union mergers and should leave Goodwill in as part of the calculation.

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## Dividend Restriction

The NCUA's starting point for restricting dividend payments is too high at a 6% Net Worth Ratio (NWR) and should reconsider changing this to 5%. Future recessions, unforeseen market swings and the influx of seasonal deposits can all impact a credit union's NWR. Having this threshold set at 6% does not adequately account for these natural market fluctuations and discounts management and the Boards of credit unions' knowledge and ability to manage the liability portion of the balance sheet in unison with its assets.

## Specific Recommendations to Risk Weights (no risk weighting should be more than 100% of the asset pool)

**Cash on Deposit & Cash Equivalents** – Should be zero.

**Investments guaranteed by the US Federal Government** – Should be zero.

**Other longer-term investments** – GTE recommends reducing the weights and number of tiers to the following:

- Investments with WAL < 3 years = 0% weight
- Investments with WAL 3 – 5 years = 50% weight
- Investments with WAL 5 – 10 years = 75% weight
- Investments with WAL > 10 years = 100% weight

**Consumer loans** – GTE recommends a 50% risk weight.

**Delinquent consumer loans** – GTE recommends 100% risk weight

**Mortgage loans** – GTE recommends reducing the proposal weights and tiers to the following:

- 1st Mortgages: < 30% of Assets = 50% risk weight
- 1st Mortgages: > 30% of Assets = 75% risk weight

**Delinquent 1st Mortgages** – GTE recommends a 50% risk weight. This weight accounts for 50% equity remaining in the home. This would need to exclude those loans already specifically reserved for in the ALLL calculation since this would be double reserving.

**Other real estate loans** – (made up mainly of home equity loans) – GTE recommends these be treated as consumer loans and carry a 50% risk weight for non-delinquent and 100% for delinquent loans.

**MBLs** – GTE recommends risk weights be broken down by types of loans and a risk weight of no more than 100%. MBL concentration levels are what impacted credit unions in the last economic down cycle, not the percentage of assets.

**Corporate credit union Perpetual Capital** – GTE recommends a 100% risk weight.

**CUSO investments & loans** – The only loss that can be taken from a failed CUSO would be the dollars invested or the dollars loaned to it. Any reserve in excess of that amount would more than discourage investment in CUSOs which have had significant benefit to the credit union industry and provided affordable innovation. GTE recommends breaking down CUSOs to their specific purpose such as operational, fee generating, or start-up (less than 5 years in operation), and carry risk weights as follows:

- Operational CUSO = 50%
- Fee generating CUSO = 0%
- Start-up CUSO = 100%
- CUSO loans = 100%

**Mortgage Servicing Assets** – GTE recommends that MSRs be broken down into two categories: recourse and non-recourse sold loans, with the following risk weights:

- MSRs with no recourse = 50% risk weight (only risk is the loss of MSR value but can never go below $0)
- MSRs with recourse = 100% risk weight (this carries the risk of buy-back)

**Other assets** – The majority of this category is Fixed Assets. GTE recommends creating a separate tier for Land & Building to this major category with the risk weights as follows:

**Fixed Assets** – Land & Building = 50% risk weight

**Other Assets** – all other = 100% risk weight

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**Off-Balance Sheet Activities** – A majority of this is composed of lines of credit for credit cards and HELOCs which have not been used. GTE recommends these be counted at 0% risk weight since they cannot present an actual loss until funds are used. Trying to reduce liquidity risk with an off-balance sheet assessment of RBC does not produce any liquidity, it only reduces loan and earnings opportunities.

**Member Shares** – This proposal does not include any consideration for a credit union's ability to manage member deposits as an instrument to manage interest rate risk. There is a natural hedge built into credit unions' deposit base (deposit rates considerably less than loan rates) and should be considered in this proposal.

## Summary

The NCUA's current proposal for Risk Based Capital will have a hobbling effect on the credit union industry as we know it today, causing a flatline of growth and an unnecessary buildup of capital in what should be regular return to the member. The major shortfall in this proposal is that the designers are trying to limit (eliminate) all risks which a credit union faces, and in the process it limits the ability of credit unions to make the needed earnings to assure competitiveness in the marketplace while building capital. It would be putting us at a competitive disadvantage and invalidating the credit union franchise model to its members which it was designed to serve.

GTE strongly urges the NCUA to revisit this proposal and build a Risk Based Capital tool that examiners can use to identify levels of heightened risk, which in turn, the NCUA can then use as a tool to address these concerns through the examination process as opposed to the current proposal which attempts to apply a single formula with punitive risk weights and imposes a potential perverse negative impact on the credit union industry.

The following is how our low-income credit union would look to its members if the RBC as designed goes into effect:

- The credit union would only offer high FICO score loans for automobiles rather than lending for basic transportation to work. Other loans such as credit cards and home improvement loans would only be granted to those with a high level of credit worthiness – excluding those with marginal credit or believable stories. This will have the effect of excluding a good portion of the members its charter is designed to serve. A recent analysis of the loan applications offered to GTE indicate FICO levels that would tip denial rates in excess of 70% – if we were attempting to avoid any delinquency at all.
- Our partnership with other non-profits such as Wheels of Success and United Way that provide transportation to work for low-income individuals would have to be stopped – it is solid business but subject to late payments on occasion and higher ALLL contributions, which would be prudent, but not counted towards capital if it exceeds 1.25%.
- Our creative programs with the local housing agencies would again be reduced due to the higher reserves we would be putting into ALLL that would not be directly tied back to capital credit.
- We would again be encouraged to sell all home loan originations servicing released so as not to put an MSR on the books. In our opinion, MSRs, when properly managed and monitored, provide long term off balance sheet income necessary in today's world of shrinking margins. This would further cause us to impose new fees for items other than bad behavior – a dramatic change from our fee aversion for basic banking. We agree that there is significant risk with MSRs supported by recourse sales and they should be looked at differently.
- The current RBC draft would encourage us to lend money to CUSOs rather than invest in them. It would probably cause us not to invest in them at all (and probably not lend to them either), and in fact, the CUSO model would probably become extinct since the $2.5 for every $1 invested in capital is a disincentive at best. We are exploring using the CUSO model to partner with other credit unions to leverage scale to secure grant monies that would be used to further our mission as low-income credit unions. This effort would also become fruitless if RBC goes into effect.
- GTE is committed to helping small businesses succeed. We are unfortunately dealing with the legacy assets that we believe should have higher RBC allocations (high balance real estate loans). In order to encourage MBL origination, loans of less than $750k should be treated like any other loan and be categorized as consumer or mortgage. This would encourage making these types of loans. If the RBC goes into effect, credit unions may be discouraged from doing any MBL lending due to the high allocation of capital necessary.

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GTE's Board, Supervisory Committee, and Executive team held a moderated strategic planning session dedicated to the potential effects of the proposed RBC structure, now and in the future. The following summarizes the outcome of that discussion and also supports the recommended changes detailed above.

> It is hard to find the logic in this proposed regulation. It is an overreaction to a problem that did not exist for natural person credit unions.
> It is a case of managing for the benefit of the fund, not the institutions working on behalf of consumers and members.
> These regulations threaten our identity, our ability to differentiate ourselves in the market, and our ability to serve members of modest means.
> These regulations will artificially raise pricing and our ability to return-to-member diminishes. The net result is a loss of value and relevance for our members. As choice is reduced and prices go up, all consumers lose.
> From the members' point of view, it will look like we are breaking our promise.
> While we will survive the proposed changes, we will be markedly different and unable to meet our mission to make loans to members for affordable housing and transportation. There is no upside for the underserved. It is a very visible loss of service which impacts the people in our communities who can least afford it.
> At GTE Financial, we have been there. We know the challenge of having to focus our strategic energies on capital at the expense of the best interest of our members. We have worked our way out of that problem but this regulation would force us to work again for capital and not on behalf of our members.

Thank you for the opportunity to comment on this proposed rule and for considering GTE's views on risk based capital requirements.

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on behalf of the Board of Directors for GTE Financial

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