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May 8, 2014

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

MAY12'14 PM 2:37 BOARD

RE: RIN 3133–AD77

Dear Mr. Poliquin and Members of the Board:

The Mountain West Credit Union Association ("the Association") appreciates the opportunity to comment on the National Credit Union Administration's (the "Agency" or "NCUA") proposed rule reforming the Agency's current Prompt Corrective Action Rule. The Association is a regional credit union trade association representing more than 130 state and federally chartered credit unions across Arizona, Colorado and Wyoming with assets of more than $31 billion and more than three million members.

The Association applauds the Agency's efforts to reform its current capital and net worth rules and agrees that reforms are necessary. However, the Association believes the proposed rule does not adequately address credit unions' capital needs and is harmful to credit unions and, ultimately, their members. We offer the following comments and urge the NCUA to reconsider its proposal.

1) <u>General Comments</u>

   With few exceptions, credit unions' cooperative structure permits capital growth to occur only by means of retained earnings. Unlike banks that can raise capital in the open market, credit unions must rely on net income for capital growth – obviously a much less expedient means. The proposed rule's risk-based capital ratio requirements will force many credit unions to seek greater net income at the expense of their member-owners to meet the proposed rule's risk-based capital ratio requirements. As an alternative to increasing capital as a means of improving net worth and risk-based capital ratios, credit unions can manipulate their balance sheets by shrinking and/or rebalancing assets. This, too, comes at the expense of credit unions' members because of the risk weights applied to various asset categories under the proposal. The proposed risk weights will require many credit unions to significantly restrict, or eliminate entirely, first mortgage lending, forcing members to seek mortgages from higher-priced competitors. This flies in the face of the cooperative structure and spirit and, ultimately, puts credit unions at a significant competitive disadvantage with their for-profit counterparts. The Association encourages the Agency to carefully

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consider expanding the use of supplemental capital as an alternative for credit unions to improve capital adequacy.

2) Authority for the Proposed Rule

The Federal Credit Union Act (12 U.S.C. § 1751 et. seq., the "Act") requires the Agency to establish risk-based net worth requirements for credit unions that are complex as defined by the NCUA Board (the "Board"). See, 12 U.S.C. § 1790d(d)(1). The proposed rule establishes a risk-based capital ratio requirement of 10.5% for a complex credit union to be considered "well capitalized." However, the Board's authority to establish risk-based net worth standards in excess of the prescribed, statutorily mandated net worth ratios is expressly limited by the Act to the "adequately capitalized" category. The Act provides that, "The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be *adequately capitalized* may not provide adequate protection." 12 U.S.C. § 1790d(d)(2) (emphasis added). This statutory provision prevents the agency from prescribing a risk-based capital ratio requirement for credit unions that are well capitalized under the statutory definition and effectively sets a congressionally mandated cap on the risk-based capital ratio requirement at 7%. See, 12 U.S.C. § 1790d(c)(1)(i).

The Act further requires the NCUA to consider the unique structure of credit unions in its regulations implementing any system of prompt corrective action. See 12 U.S.C. § 1790d(b)(1)(B). The Act expressly requires the Agency to consider that credit unions cannot issue capital stock and that they must rely on retained earnings to build net worth. See 12 U.S.C. § 1790d(b)(1)(B)(ii) and (iii). The proposed rule's risk-weightings are generally more stringent than those required for small banks under the Basel risk-weighting system. As mentioned above, these more restrictive risk-weightings would force credit unions to manage their balance sheets to meet regulatory capital standards, resulting in programs, specifically mortgage lending, being severely restricted or eliminated altogether. This result creates a significant competitive disadvantage for credit unions.

3) Basis for the Proposed Risk-Based Net Worth Requirements

The purpose of the net worth and risk-based capital requirements is to ensure that credit union members are adequately protected against economic and other

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concerns that threaten the banking system. To do this, the share insurance fund must ensure it can remain solvent in the face of these threats by establishing sufficient capital requirements for credit unions. Since 1988, and through the last two U.S. financial crises, the credit union share insurance fund has not fallen below 1.23% of total insured shares – only hitting this low point during the peak of these crises. In stark contrast, the Bank Insurance Fund has become technically insolvent during these financial crises. Clearly, the current capital requirements prescribed by statute, and the regulatory scheme of implementation, are sufficient to meet foreseeable economic risks. The Agency cites no concrete facts that evidence the need for credit unions to maintain capital levels far more restrictive than those of other depository institutions.

4) <u>Comparison With Basel III Requirements – Requirements for Banks</u>

The Act directs the NCUA to prescribe a system of prompt corrective action that is comparable to the system prescribed for other insured depository institutions under 12 U.S.C. § 1831o. The Agency's proposed rule, however, establishes risk weightings for numerous asset categories that are punitive as compared to the Interim Final Rule adopted by the Federal Deposit Insurance Corporation (the "FDIC"). See, 78 F.R. 55340 (September 10, 2013) (the "FDIC Rule"). These punitive risk weights appear to be, at least in part, the result of NCUA's stated goal of addressing risks other than credit risk. See, 79 F.R. 11184 (February 27, 2014). However, the FDIC Rule is expressly limited to account only for credit risk. See, 78 F.R. 55340 at 55362. The significant differences in the NCUA's proposed rule and the FDIC Rule results in the NCUA's proposed rule lacking the requisite, statutorily prescribed comparability. The FDIC Rule relies on other means of assessing an institution's capital needs and determining the appropriate risk-based capital ratio requirement. This allows the FDIC to consider the unique circumstances of each institution to more accurately assess their needs. Such a system also allows each institution to manage their capital needs based on the institution's size, complexity and staff expertise.

The NCUA states that the proposed rule would establish a risk-based capital ratio method more commonly applied to depository institutions and would improve the comparison of assets and risk-adjusted capital levels across financial institutions. See, See 79 F.R. at 11186. However, because neither the FDIC Rule, nor the Basel III standards, attempt to incorporate risks other than credit risk into the evaluation of capital needs, the proposed rule does not accomplish this stated objective.

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5) Capital Elements of Risk-Based Capital Ratio Numerator

a) NCUSIF Capitalization Deposit. The proposed rule sets forth those items to be included as part of the risk-based capital ratio numerator and the items to be deducted from the numerator. The Association believes that the NCUSIF capitalization deposit should not be deducted from the numerator. The NCUSIF capitalization deposit represents credit union funds on deposit with the National Credit Union Share Insurance Fund to capitalize the fund. These funds are an asset of the credit union and would be reclaimed by the credit union in the event of a voluntary liquidation or conversion to another form of charter. These funds are a "reserve" that serves to protect the NCUSIF from potential losses. Because these funds are held directly by the Agency, are not subject to claims of creditors and are an asset of the credit union, the NCUA should not deduct the capitalization deposit from the risk-based capital ratio numerator amount.

b) Goodwill. The recent economic crisis necessitated a number of mergers among credit unions, many of which were undertaken by credit unions at the behest of the Agency, and would not have been entered into by the continuing credit union but for the goodwill obtained through the merger. Goodwill was an important factor in evaluating these mergers because it represented real value in accordance with Generally Accepted Accounting Principles ("GAAP").

6) Appropriateness of Proposed Risk-Weights

a) Generally. As previously noted, the risk-weightings assigned by the proposed rule to various asset categories result in a lack of comparability with the FDIC Rule and Basel III. In addition, the proposed risk weights appear arbitrary and lack a rational basis supported by evidence of need. Further, if the NCUA is attempting to account for risks other than credit risk, the risk-weight categories create inconsistencies in risk measurement.

b) Category 10 – 1,250 Percent Risk-Weight. The category 10 risk-weight may be applied to an "asset-backed investment" at the discretion of the agency without any objective standards to measure a credit union's "comprehensive understanding." The proposed rule does not condition the exercise of this discretion on any due process, giving the field examiner the ultimate authority to require such classification. The Agency

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acknowledges that not all field examiners are subject matter experts in all areas. A field examiner's own lack of understanding of an investment may mislead an examiner to determine that a credit union does not possess the requisite comprehensive understanding and, therefore, inappropriately apply a Category 10 risk-weight. In addition, the term "asset-backed investment" is not defined in the proposed rule. While this term may be understood to have a generally accepted industry meaning, the import of the proposed rule demands certainty of the term's meaning.

The lack of any objective standards for measuring a credit union's "comprehensive understanding," unfettered examiner authority to apply a Category 10 risk-weighting, and the lack of a definition of "asset-backed investment" combine to make the Category 10 risk-weighting inherently unfair given the significant impact of such risk weighting on a credit union's risk-based capital ratio. For these reasons, the Association believes the NCUA should eliminate the Category 10 risk-weight. In the alternative, we urge the Agency to provide objective standards for judging the credit union's "comprehensive understanding," provide a system of due process, ensure field examiners have sufficient knowledge to evaluate these types of investments and provide a detailed definition of "asset-backed investment." Finally, the Association feels strongly that credit unions should be permitted to engage, and rely upon the expert opinions of, independent third-party experts to evaluate and quantify the risks associated with these types of investments, and that the opinions and judgment of these experts be imputed to credit unions.

c) CUSO Loans/Investments. The proposed rule requires the total value of a credit union's investments in a CUSO receive a risk-weighting of 250% and the total outstanding principal amount of a credit union's loans to a CUSO receive a risk-weighting of 100%. As with other categories of risk-weights, these appear to be arbitrarily assigned, do not account for the financial strength of the particular CUSO and the Agency does not offer a rational basis for the vast difference in risk-weights between loans and investments.

d) Member Business Loans. The proposed rule assigns two distinct risk-weights to member business depending on concentration. As previously mentioned, the Association believes it is inappropriate to implement a system of risk-based capital that attempts to include risks other than credit

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risk. In addition, the 200% Category 8 risk-weighting is arbitrary and lacks a sufficient rational basis for such a high risk-weight.

7) Effective Date

The proposed rule makes comprehensive and complex changes to NCUA's existing system of prompt corrective action resulting in significant impact on credit unions' balance sheets and systems of capital planning. Such sweeping changes will require sufficient time to transition from the existing regulatory scheme to ensure proper implementation and avoid any unforeseen consequences. The Association urges the NCUA to adopt a minimum five-year transition period for a rule having such a significant impact.

Summary

The Association agrees with the NCUA that capital reforms are necessary and appropriate, and we appreciate the Agency's efforts in this endeavor. However, for the reasons stated above, the Association feels strongly that the current proposal puts credit unions at a significant competitive disadvantage with banks, does not accomplish its stated purpose, does not comply with the statutory requirements of the Federal Credit Union Act for comparability with FDIC rules implementing Basel III , and will ultimately harm credit union members and consumers by forcing credit unions to restrict or eliminate important lending programs. The Association respectfully requests that the Agency abandon the proposed rule in its entirety, and recommends seeking credit unions' input through the process of advanced notice of proposed rulemaking. In the alternative, and at the very least, we urge the NCUA to adopt a rule that does not depart from the FDIC-Basel III regulatory scheme except as appropriate and necessary to reflect credit unions' unique differences.

Respectfully,

Mark D. Robey
SVP of Regulatory Affairs