Dover Federal
CREDIT UNION
1075 Silver Lake Blvd., Dover, DE 19904

May 14, 2014

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

RE: Prompt Corrective Action; Risk-Based Capital, 12 CFR Parts 700, 701, 702, 703, 713, 723 and 747

Dear Mr. Poliquin:

Thank you for the opportunity to comment on the proposed Prompt Corrective Action; Risk Based Capital Regulation.

Dover Federal Credit Union (Dover Federal, Credit Union) was formed to serve the men and women on Dover Air Force Base, both active duty and civilians in 1958. Over the years, the field of membership has expanded to over 300 select groups. Currently, Dover Federal serves 39,403 members and has $403 million in assets.

While there is no doubt that the current capital regulations need to be updated, I believe that the National Credit Union Association has reacted over aggressively to past financial conditions and as a result created a regulation that places credit unions at a disadvantage in the financial services industry. Additionally, there has not been sufficient evidence or losses to prove a need to replace the current leverage ratio methodology with a risk based methodology.

Complex Credit Union

Under current §702.103 of NCUA's regulations, [1]a credit union is defined as "complex" if "[i]ts quarter-end total assets exceed fifty million dollars ($50,000,000); and . . . [i]ts [RBNW] requirement, as calculated under § 702.106, exceeds six percent (6%)." Current § 702.104 of NCUA's regulations defines eight risk portfolios of complex credit union assets, liabilities, or contingent liabilities. The proposal defines a credit union as complex if its assets exceed $50 million, regardless of the composition of their balance sheet. This arbitrary level is extremely low in today's financial services industry and significantly lower than the threshold established for banks and bank holding companies of $15 billion, contingent upon their business practices and balance sheet composition. There are probably a significant number of credit unions in the $50 million to $500 million asset range that are not complex by today's qualifiers. Arbitrarily classifying them as complex based upon their asset size does not strengthened the credit union industry or protect the insurance fund. In fact, doing so will probably have the opposite impact.

[1] National Credit Union Administration (2014, February 27). Federal Register. Part II, Vol. 79, No. 39 pp. 11185, Proposed Rules

Capital Requirements Significantly Higher Than Banks

NCUA states in the proposal that "The proposed revisions would include a new method for computing NCUA's risk-based capital measure that is more consistent with the risk-based capital measure for corporate credit unions and the risk-based capital measures used by the Other Federal Banking Regulatory Agencies." and "In general, credit unions have high quality capital, with retained earnings being the predominant form of capital." In fact the proposed risk ratings are much higher than those required by Other Federal Banking Regulatory Agencies.

Investment Risk Weights		
	NCUA Proposal	Basel III
Maturities of 0 to 1 years	20%	20%
Maturities of 1 to 3 years	50%	20%
Maturities of 3 to 5 years	75%	20%
Maturities of 5 to 10 years	150%	20%
Maturities >10 years	200%	20%

First Mortgage Risk Weights (non-delinquent)		
	NCUA Proposal	Basel III
Total book balances <25% of assets	50%	100%
Book balance in excess of 25% and less than 35% of assets	75%	100%
Book balances in excess of 35% of assets	100%	100%

Other and Delinquent Real Estate Risk Weights		
	NCUA Proposal	Basel III
Total book balances <10% of assets	100%	100%
Book balance in excess of 10% of assets and less than 20% of assets	125%	100%
Book balances in excess of 20% of assets	150%	100%

Business Loans		
	NCUA Proposal	Basel III
Total book balances <15% of assets	100%	100%
Book balance in excess of 15% of assets and less than 25% of assets	150%	100%
Book balances in excess of 25% of assets	200%	100%

Delinquent loans – NCUA's proposal and Basel III both use a risk weight of 150% for delinquent loans. However, a loan at a bank is not classified as delinquent until it is more than 90 days past due while NCUA considers a loan past due at 60 days.

The above recommended risk weights are contrary to the purpose NCUA stated in the Federal Register. Furthermore, it is hard to envision why risk weights for credit unions need to be greater than their banking counterparts considering the overall performance of the credit union industry over the past five years compared to the banking industry. However, what is truly ironic is that during the FDIC's April 8, 2014, board meeting, the Bank Insurance Fund approved a new rule to strengthen the leverage capital requirements for the eight largest, most systematically important banking organizations. The new rule requires a 6% leverage ratio for the insured banks to be considered well-capitalized under prompt corrective action. Bank holding companies would need to have a leverage ratio of 5%. By comparison, the Basel framework requires only a 3% minimum leverage ratio for both levels of a banking organization. During the meeting, FDIC chairman Martin J. Gruenberg said the leverage approach "benefits the financial system as a whole and reduces the potential systemic risk these institutions pose." He supported the cooperative model's capital standard saying: "This is a rule of significant consequence. In my view, this final rule may be the most significant step we have taken to reduce the systemic risk posed by these large complex banking organizations." In a more extensive statement, FDIC vice chairman Thomas M. Hoenig [2]laid out the benefits of a leverage ratio versus the traditional risk-based approach: "The supplementary leverage ratio is a more reliable measure that is simple to calculate, understand, and enforce than the subjective risk-weighted measures, and it provides a highly useful initial assessment of a bank's balance sheet strength...Experience has shown that relying only on a risk-based capital measure serves the public poorly ... As recently as year-end 2013, reported risk-based capital ratios for the largest global banks averaged 13% while the average leverage ratio was less than 5% .... .I am confident that supervisors will rely increasingly on the leverage ratio, as the market already does, to judge a firm's capital levels, loss absorbing capacity, and balance sheet strength". A third FDIC board member, Jeremiah O. Norton, supported the rule with the following points: "There is recent economic research to support the conclusion that the leverage ratio is a statistically significant predictor of bank default while the Basel Tier I risk-based capital ratio is not."

If NCUA wishes to be more closely aligned with the Other Federal Banking Regulatory Agencies why is there an emphasis on risk based capital versus when the FDIC is moving from such standards?

Individual Minimum Capital Requirement

The proposed rule provides NCUA the ability to require a higher minimum risk-based capital ratio for an individual credit union in any case where NCUA determines that the credit union's capital is or may become inadequate in light of the credit union's circumstances regardless of the actual risk based capital ratio of the credit union. In addition to the questionable legality of this section, this portion of the regulation challenges the entire purpose of the rule. The proposed regulation and risk weights are being established to ensure that credit unions are adequately capitalized to be prepared for a number of risks including concentration risk, interest rate risk, credit risk, market risk, operational risk, and liquidity risk. However, if NCUA decides that their risk-based capital ratios are inadequate, the NCUA can create new standards for an individual credit union. In reality, doesn't NCUA already have this power through their corrective action procedures and the use of documents of resolution (DOR) or cease and desist orders?

[2] Filson, Chip. (2014, April 10). FDIC Approves A Simple Leverage Ratio to Improve Capital Adequacy Standards. www.cutimes.com

CUSOs

The proposal would set the risk-weight at 250 percent for investments in CUSOs and 100 percent for loans to CUSOs. However reasoning for the differences is not provided. Less than 22 basis points of credit union assets are invested in CUSOs. Therefore, there does not appear to be systematic risk that threatens the share insurance fund. However, this proposed rule could force credit unions to amend and/or reconsider their business plans. Risks of this nature should be managed through the examination and supervision process and not by a one size fits all approach.

Implementation Period

The proposed 18 month implementation timetable is insufficient for a rule with such broad impacts on all operations of credit unions. Furthermore, it fails to meet NCUA's stated purpose of becoming more closely aligned with the Other Federal Banking Regulatory Agencies as banks were given a three year period to prepare for the implementation of the BASEL standards.

I trust that the NCUA Board will review all of the submitted comments to create an improved capital regulation that protects the credit union industry and the share insurance fund without placing arbitrary undue hardships on credit unions that will prevent us from providing the products and services that our members want and need.

Sincerely,

David W. Clendaniel
President/CEO