May 14, 2014

Mr. Gerard Poliquin
Secretary, NCUA Board
1775 Duke Street
Alexandria, VA 22314

Re: Risk-Based Capital Proposed Rule

Dear Mr. Poliquin and NCUA Board:

Thank for you allowing us to comment on the proposed Risk-Based Capital rule. I believe that risk-based capital in general is a good idea for the Credit Union industry. A move to such a framework explicitly recognizes that riskier activities require more capital, and requires institutions who decide to undertake those activities understand the capital requirements of their decisions. It also explicitly helps remedy issues such as having to fully capitalize cash equivalents that result from low-risk core deposit growth. This effect will potentially be of great help during economic conditions which induce consumers into flights of safety-type behavior. However, in its current form I have two strong concerns, which I believe are echoed by many in our industry.

Individual Minimum Capital Requirements

My first concern is section 702.105, Individual Minimum Capital Requirements. Of my two concerns, this is by far my strongest. In its current form, the rule allows the NCUA to increase capital requirements for such vague and arbitrary issues as “A credit union is receiving special supervisory attention” or “A credit union has inadequate underwriting policies, standards, or procedures for its loans and investments.” In the first example, the term “special supervisory attention” allows for just about any justification of an IMCR. In the second example, with no definition for “inadequate,” an examiner could use just about any reason to deem policies such.

While I recognize that issuing an IMCR under 702.105 is subject to a review process under 747.2006, the process itself is basically self-contained within the NCUA and thus does little to address the vagueness and arbitrariness in 702.105. Stated simply, because the rule is so arbitrary, the NCUA Board would conceivably never be outside their authority to issue IMCRs, regardless of the credit union’s protestations to the contrary. Therefore, it would render the review process largely meaningless.

The intent of this rule vis-à-vis the Federal Credit Union Act must also be questioned. Under the FCUA, actions such as downgrades may not be delegated by the NCUA board, and are subject to a vigorous review process. Under this rule, power is given to the NCUA to implicitly impose a downgrade through the imposition of an IMCR with a process that is nowhere as vigorous as the one currently in place. This rule would effectively delegate such authority to parties other than the NCUA board as it is currently written. Furthermore, with the vagueness and arbitrariness noted above, this rule represents a significant power grab by the NCUA regulators over the imposition of capital standards. My belief is that, should the rule be put through in its current form, the NCUA would face a significant legislative backlash. Therefore, I would strongly recommend that the NCUA board consider removing this section from the proposed rule in its entirely.

Risk Weights

My second concern regards the apparent arbitrariness of the asset risk weights. While it is made clear that congress has encouraged the NCUA to design the RBNW rule in such a way that "The design of the [RBNW] requirement should reflect a reasoned judgment about the actual risks involved", it appears that the proposed asset weights are also being used for policy/socio-economic reasons, rather than a purely risk-based measure.

For example, the imposition of a 150% weight on investments between 5 and 10 years average life is particularly capricious. To demonstrate, let's compare a 30-year mortgage-backed security against a pool of 30-year mortgage loans along 5 risk dimensions:

Risk Type	30-Year Agency MBS	30-Year Mortgage Loans
Interest Rate	Moderate	Moderate
Credit	Low to None	Low to High
Liquidity	Low	Low
Operations	Low to None	Moderate
Market	Low	Low

In no category is the 30-year agency MBS a higher risk than the 30-year mortgage loans. Both represent low liquidity and market risk, due to large, liquid markets for both assets. Both represent moderate interest rate risk, due to their average life. However, the mortgage loans represent potentially much higher credit risk, and more operations risk due to compliance issues. Therefore, there is no risk-based reason for the investment to bear a higher risk weight than the loan pool. The only reason that such a weight would be imposed must be a policy/socio-economic rationale, such as wanting credit unions to make more loans than investments. However, I would submit that a RBC framework is not the place to advance policy and socio-economic interests; its sole purpose should be to manage risk.

Therefore, risk weightings should truly make sense and be relative to the risks that the assets bear. In no case should a credit-insured investment be a higher weight that its equivalent loan. Basel guidelines reflect this, as does the FDIC rule. While I understand that weights will potentially be different than Basel or the FDIC due to the different risks being accounted for, an objective, transparent process should be put into place that determines the risk weights. The process should show the relative weight of each risk being applied to the asset, and any reasons for substantial deviation from the objectively determined weight. Such a process would result in a far more consistent and objective system of weights, which in turn would best achieve the RBC's stated goal: managing risk.

Conclusion

While the RBC proposal represents a step forward in many ways in regard to managing risk, the current version is far too problematic. The section on IMCR is far too vague and arbitrary, and it implements a far weaker than current regulatory oversight mechanism that is unacceptable. Based on my own experience with regulation and examiners, year-to-year priorities and levels of competence are too variable to willingly give that level of power to the agency without appropriately strong oversight. The risk-weights also need serious revision, preferably with a transparent and objective weight assignment process.

Without such revisions, the proposed rule will be so onerous as to put credit unions at a serious competitive disadvantage versus virtually all other providers of financial services, while making us no less risky.

Thank you once again for the opportunity to comment on this very important piece of rulemaking and your consideration.

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