May 12, 2014

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

Re: 12 CFR Part 700, 701, 702, 703, 713, 723, 747 Prompt Corrective Action – Risk-Based Capital

OSU Federal Credit Union appreciates the opportunity to comment on the Proposed Rule on Prompt Corrective Acton and Risk Based Capital.

Founded in 1954 to serve Oregon State University, OSU Federal Credit Union currently serves a five county area in mid-western Oregon as a community credit union. We have grown in membership to over 78,000 with assets totaling $868 million. Our members believe that we have their interest at heart and look to us for a full range of products including real estate loans (offered since 1986) and member business loans (offered since 2000), not just consumer loan products. Although loans are what are being measured in this rule, our members value our deposit and savings products as well.

OSU Federal currently maintains a net worth level of over 10.5% of total assets, which is a buffer of around 3.5% above the "well capitalized" level. According to the risk-based capital calculator, our risk-based capital ratio would be over 15% reflecting a buffer of 4.5%. This may seem like a good capital position by NCUA, but these capital ratios are measuring a balance sheet that has been positioned during the recession to hold a limited amount of risk in either long term investments or long term assets. Our balance sheet doesn't reflect our typical level of loans or a longer term structure within our investment portfolio. Looking at our typical balance sheet structure, our buffer over the proposed risk based capital ratio drops closer to 2.5%. As the buffer moves lower over time and we return to a more traditional balance sheet, the flexibility to make decisions that serve our members' needs will be hampered by NCUA's desire to manage credit union's balance sheet through altering the cost of capital.

We respect the fact that NCUA is called by the Federal Credit Union Act to review the capital standards and ensure that the rules stay current and comparable to the banking industry. But

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we are challenged to understand why NCUA feels that the proposed capital rule for credit unions needs to be more stringent than BASEL III used by the banking industry.

We do not believe that the Act requires a capital standard to be more restrictive or punitive, only that the inherent difference in credit union structure be considered in the rule making process. The Act states that relevant risks be considered if the risks are not able to be mitigated through the basic net worth held on the balance sheet.

Credit unions have just come through the greatest recession since the 1930's with a strong record of success. It has been noted that less than 1% of credit unions failed over the last several years versus a 5% failure of banks over the same time period. It appears that even with more limited ways to raise capital, credit unions exhibited less risk to insurance funds than our banking counterparts, yet our regulator wishes to impose a stronger risk capital requirement.

Unintended Consequences

The result of the proposed rule on the credit union industry will have many unintended consequences to the industry. Although NCUA states that the rule should not be a sign of how credit unions manage their balance sheets just that an appropriate level of capital be held, the part of the rule allowing examiners to impose a higher level of capital at their discretion speaks to NCUA's expectation of the rule's influence on credit union decisions. Credit unions will need to evaluate their willingness to deviate from NCUA's prescribed allocation of assets based on the likelihood of examiner response.

At a time when credit unions are just starting to see an uptick in consumer lending from a slowly rebounding economy, the proposed capital rule will negatively impact growth in several lending categories. It will place credit unions in a position to charge higher fees and loan rates and discourage new member deposits. This will impact the earnings for the industry and in turn affect the ability to grow capital.

In addition to the impact on credit union's individual behavior and decisions, the credit unions will not be as competitive as banks from the consumer's view point impacting the level of service to "people of small means," which is one of the purposes stated in the Federal Credit Union Act. How will credit unions be as able to remain relevant to their membership if the ability to bring financial value is constrained by the capital rule? Credit unions already live under a more restrictive set of regulations such as loan limits, investment types, and delinquency calculations. Why impose even more regulation that will hurt the competitive position for credit unions and significantly impact our mission? At some point, credit unions may not be able to fulfill their intended role to stabilize or balance the credit structure in the United State as initially laid out in the Federal Credit Union Act.

NCUA has over the last few years implemented many sets of guidance or regulation that have improved credit union's focus and the examination process for Liquidity Risk, Concentration Risk, and Interest Rate Risk. These risks should be evaluated at an entire balance sheet level, taking into account actions on the liability side of the balance sheet that mitigates risk on the asset side. A capital requirement focused on assets only is not the best way to manage these risks.

We also believe that NCUA's decision to assign complexity solely based on asset size is inappropriate and does not really meet the intent of the Federal Credit Union Act. If there is a requirement to determine complexity, then the determination should be made based on structure or risk of the entire balance sheet rather than based on size.

From our review of the proposed rule, there are several risk weightings that are quite excessive. These risk weightings are more punitive than the comparable risk weightings for bank capital requirements. This is of concern to OSU Federal as it would place all credit unions at a competitive disadvantage in the financial industry.

Cash Held at the Federal Reserve

It appears from the proposed rule, that deposits held at the Federal Reserve would be considered under cash equivalents and would fall under the 20% capital weight. It would seem that it would be appropriate to be weighted at 0% risk since they are held by the Government and should be considered similar to holding investments guaranteed by the US Government. In fact under Basel III, central bank reserves are deemed to be highly liquid assets and carry a 0% risk weight. **OSU Federal believes the rule should be revised to place a 0% risk weight on balances held at the Federal Reserve.**

Investments

Under the proposed rule, it appears that NCUA has placed all of the risk weighting emphasis on interest rate risk, rather than credit risk or a combination of the two, with the exception of US Government guaranteed bonds. In fact it appears that a private label mortgage backed security would have the same risk weight as an agency or municipal bond with a government backing. In addition the longer term investments, regardless of issuer, are assigned a much higher risk weight in comparison to the banking industry, credit unions are again placed at a competitive disadvantage with the rest of the financial industry.

The disparity between the risk assigned to a 5 year agency bond of 150% versus the risk of an unsecured VISA loan at 75% is unjustifiable. The same bond in fact has the same risk weight as a delinquent VISA loan at 150%. These risk weightings would assume that the 5 year bond holds much more risk than the loan, yet we all understand that the bond is more marketable and has almost no credit risk in comparison to the loan.

Another example of the disparity on how the risk weights have been established for investments would be to compare the risk assigned to a 10 year agency bond of 200% compared to the highest risk assignable to a 30 year fixed rate mortgage loan of 100%. The agency bond continues to provide lower credit risk, lower interest rate risk and lower liquidity risk to the organization than the mortgage loan. NCUA's decision to risk weight low risk investments only encourages credit union to seek out a higher concentration in loans or longer term treasury investments rather than use agency and municipal bonds. **OSU Federal believes**

investments should be risk weighted by issuer quality and be more in alignment with Basel III's structure.

First Lien Residential Mortgage Loans
Under the proposed rule, first lien residential mortgage loans are risk weighted by concentration levels from 50% to 100%. Under Basel III, the majority of loans fall under 50% risk weight. The only higher risk weights for first lien mortgage is based on delinquent status or underwriting standards not based on amount of loans portfolioed.

One example of the inconsistency in risk weighting would be to compare a higher concentration of 30 year mortgage loans which are fully collateralized and risk weighted at 100% compared to an unsecured VISA loan at 75%. Just because more loans are held in collateralized first lien mortgages does not mean that there is more risk to the balance sheet than an unsecured loan. **OSU Federal believes that the Basel III weights of 50% should be adopted for all first lien mortgage loans.**

Other Real Estate Mortgage Loans
Under the proposed rule, other real estate mortgage loans are risk weighted by concentration levels from 100% to 150%. Under Basel III, junior lien mortgage loans fall under 100% risk weight and are not based on the amount of loans portfolioed.

Again an example of the disparity created by NCUA's risk weighting is that a monthly adjustable home equity line of credit fully collateralized is risk weighted at 100% compared to an unsecured VISA loan at 75%. If a credit union holds a more sizable amount of HELOCs, the risk could rise to 150% risk weight even though it has limited credit risk, and has almost no interest rate risk. This risk weight of 150% is the same risk at which a delinquent VISA loan would be rated. It should be obvious that the HELOC loan holds lower credit, interest rate and potentially less concentration risk. **OSU Federal believes that the Basel III weights of 100% should be adopted for all other real estate mortgage loans.**

Member Business Loans
Member business loans are risk weighted by concentration levels from 100% to 200% under the proposed NCUA rule. These limits will have the unintended, or maybe intended, consequence of discouraging growth in member business loans to credit union members. Under Basel III, all commercial loans carry a 100% risk weight except for high volatile commercial real estate loans used to finance acquisition or construction of real property other than 1-4 family residential property which is weighted at 150%. It seems unrealistic that NCUA should penalize credit union so much more than the rest of the financial industry by applying as high as a 200% risk weight. **OSU Federal believes that the Basel III weights of 100% should be used.**

CUSO Investments
The NCUA proposal assigned a risk weight to investments in CUSOs of 250%. It is understandable that there is additional risk associated with an equity investment.

Unfortunately, NCUA must not have taken into account the amount of oversight they already have in regard to CUSO investments as implemented in their recent regulation. These investments are not the random equity investment for which NCUA has no ability to look more deeply at the company being invested in. In fact a high percentage of CUSOs are wholly owned and consolidated into the credit union itself. Our greatest concern is the unintended consequence that credit unions will make a determination to use a lower overall cost third party vendor who is less known and without any element of ownership control to provide the same services to members as through their existing CUSO. This action doesn't reduce the risk to the industry. Other unintended consequences include the disincentive to find efficiencies and improve earnings through economies of scale brought forward through CUSO activities. **OSU Federal believes that NCUA should consider whether this is as risky as an equity investment or should be rated at a lower risk level to encourage innovation and efficiency in the industry.**

<u>Asset Backed Investment – Too Complex for Credit Union</u>
The 1,250% weight for any asset backed investment for which the credit union is unable to demonstrate a comprehensive understanding of the features implies that the credit union stands to lose more than the face value of the bond. Although there is a similar clause for banks under Basel III, a weight higher than the face value seems punitive rather than providing for the risk itself. **OSU Federal believes that this risk should be revised downward.**

<u>Off Balance Sheet Commitments</u>
NCUA has assigned a variety of Credit Conversion Factors to multiply against the off balance sheet commitments to determine the amount which should be taken into account for the risk based assets. Under the proposed rule, all commitments are included in the risk calculation. For other financial institutions, the risk weight is 0% if the credit is unconditionally cancellable by the credit union. Other general loan commitments are risk weighted by term of the guarantee as well as type providing a much lower risk weight for other financial institutions. **OSU Federal believes that NCUA should consider a risk rating that is more in line with the rest of the financial institution capital standards.**

<u>Subjectively Determined Individual Minimum Capital Requirement</u>
The proposed rule includes a provision where field examiners can impose an Individual Minimum Capital Requirement based on their determination of need on a case by case basis. The situations that may prompt an examiner to adjust the capital requirement for an individual credit union can range from "high exposure to a specific risk category, growing too quickly, potential affect of a third party relationship, inadequate policies or procedures, or even failing to plan for earnings growth." The documented range of situations vary in scope and severity and definitely lend themselves to a tremendous amount of subjectivity on an examiner's part. Credit Unions need to be able to operate their business under regulations that are well defined. NCUA has many avenues through the examination process to handle individual management issues such as planning, policy and third party relationships. **OSU Federal believes that this section of the rule allowing for individual determination of capital adequacy must be removed.**

Delayed Implementation Deadline

The proposed implementation period of 18 months is unreasonable and places an unnecessary burden on the credit union industry. There is no evidence to justify the urgency in implementation. Basel III was approved by the banking regulators in late 2011. The beginning phase-in of the rule was in 2014 with final implementation for small organizations completed in 2019. The banking regulators felt it was appropriate to let the banking industry have this amount of time to move under the new capital rule in order to prevent potential damage to business models and service levels. **OSU Federal believes that NCUA should provide at least an equivalent amount of time for credit unions as was allowed for the banking industry.**

We would recommend that NCUA go back and evaluate the differences between the proposed regulation and BASEL's risk weightings. Credit unions need to understand why NCUA wants to place the industry under a more restrictive capital requirement. The BASEL guidance is accepted world wide as an adequate measure of capital. Although we would prefer to limit the impact of an additional risk based capital requirements, it may be better to fall under an accepted method rather than the arbitrarily developed rule that is being proposed. NCUA mentioned that they would be developing a Basel Lite for credit unions, but what is being proposed is much more onerous and harmful than Basel.

Again, thank you for allowing the industry to comment on this far reaching and impactful proposal.

Sincerely,

Bonnie Humphrey-Anderson

Bonnie Humphrey-Anderson
Executive Vice President/Chief Financial Officer