Virginia Credit Union®

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Via email: regcomments@ncua.gov

May 16, 2014

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

Re: NCUA Risk-Based Capital Proposal, RIN 3133–AD77

Dear Mr. Poliquin:

Our credit union appreciates the opportunity to provide comments on the proposal regarding risk-based (RBC) requirements under its prompt corrective action rules. I am responding on behalf of a state-chartered credit union located in Virginia with over $2.5 billion in assets and over 230,000 members.

Overall, it appears the risk weightings in many cases seem to reflect the types of loans and investments that NCUA would prefer of credit unions more so than the risk levels of the asset categories themselves. This proposal is probably most concerning to credit unions that are not as plain vanilla or not well diversified in their lending programs. This is perhaps somewhat understandable as they may pose a bigger risk to the insurance fund. However, this could significantly limit the growth opportunities of credit unions with less diversified loan mixes, especially during periods of economic downturn.

Further, there are several aspects of the rule that in our opinion may be problematic or warrant comment. Those concerns and our comments are outlined below:

1) We are concerned that NCUA is giving itself authority to impose higher risk based capital requirements on a credit union beyond the defined RBC requirements. We feel the agency has sufficient authority through the exam and Document of Resolution process to address safety and soundness issues. Although we understand NCUA's desire to curtail overly risky practices, we feel that to arbitrarily impose a new specific risk based capital ratio level on individual credit unions is a regulatory overreach.
2) Some weightings seem inconsistent amongst themselves. Weightings should reflect true risk and not penalize for business decisions resulting in similar risk levels. For example, credit unions with large Federal Reserve balances (20% risk weighting) should not have to hold more capital than those credit unions that purchased US Treasuries (0% risk weighting). Likewise agency mortgage-backed securities (MBS) should not be

weighted more than a credit union's own mortgage portfolio, particularly when collateral and credit risk have been eliminated comparing an MBS pool to a pool of held whole mortgage loans.

3) The weightings penalize longer term assets with no consideration for the liability side of the balance sheet and Asset Liability Management (ALM) measures. Based on the current makeup of our balance sheet, this does not impact our credit union very much at this time. This could however have a big impact on other credit unions that are hedging mortgage risk either through core deposits, term borrowings, and/or derivatives. This is different than bank RBC standards which are generally focused on credit risks.
4) The proposal provides for an addition to equity for the allowance for loan loss (ALL) balance up to 1.25% of risk assets. This seems appropriate as the ALL is a buffer to loss (similar to the old capital to assets ratio). However, there is a new Financial Accounting Standards Board (FASB) proposal based on expected losses that may require much higher allowance balances than what credit unions currently have. If the FASB proposal is enacted, credit unions may be more likely not to be able to add back the full amount of the allowance. We feel this limit needs to be higher or perhaps eliminated.
5) The proposal will likely cause the industry to hold even more capital reducing the overall return on equity of the industry. Even those credit unions that have sufficient capital may feel the need to hold more to increase their buffer. This could further curtail industry growth prospects, limiting consumer access to the benefits of credit union membership and services.
6) This proposal could further reduce the willingness for strong credit unions to merge with weaker ones because of the need to record goodwill under the purchase accounting rules. Goodwill is subtracted from capital (net worth +; the numerator) when calculating the risk based capital ratio, even though your risk based asset total (denominator) would be higher as a result of the merger.
7) The 18 month implementation time frame does not seem long enough for credit unions that must restructure their balance sheet as a result of the rule. It may put them in the position of selling higher risk assets to firm up their RBC ratio. This could potentially cause them to realize losses at an inopportune time, and further inhibit industry growth. Once the rules are finalized, we recommend a multi-year implementation period which we believe is more equitable and consistent with other covered financial institutions under Basel III requirements.
8) There are some complicated calculation aspects to the rule that will likely increase regulatory burden when completing the call report. For example, if you hold both the first and junior lien on a property, you can count it as one loan and report it all as a first mortgage (lower risk rating than other real estate). Although we appreciate the option to reduce risk based assets, this could complicate regulatory reporting with increased data gathering costs. We also question whether this situation truly reduces risk (i.e. the loan-to-value will still be high). Troubled Debt Restructurings also have to be pulled out

from first mortgages and put in the higher risk “Other RE” category. While we agree that these loans are more risky, we are concerned about the complexity of data gathering and reporting.

9) The proposed total value of investments in CUSOs is 250 percent. We believe this may be excessive, restrictive and stifle innovation as all CUSOs do not carry the same level of risk. Furthermore, NCUA’s newly finalized rule changes to Parts 712 and 741 provide NCUA with more oversight over CUSOs. We question whether this high a risk weight is necessary in light of NCUA’s rule changes and their ability to more closely monitor CUSO activity. Should NCUA feel a weight is necessary, perhaps consideration should be given to assigning it a lesser weight, such as 100 or 150 percent.

Thank you for considering our comments as you finalize these rules. Should you have any questions about our comments, please feel free to contact me at (804) 323-6000, ext. 5665.

Sincerely,

Beverley F. Rutherford, CIA, CUCE
VP/Compliance