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

May 6, 2014

RE: Commentary Regarding NCUA Risk Based Capital Proposal, RIN 3133–AD77

These comments are from a group of twelve credit union Chief Financial Officers representing $17 billion in assets and approximately 700,000 members. We believe the recently proposed Risk-Based Capital Rule is flawed and represents a threat to our industry.

The NCUA Board's stated purpose in proposing to amend the current regulation is to "be more consistent with...the regulatory risk-based capital measures used by the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve, and Office of the Comptroller of Currency (Other Federal Banking Regulatory Agencies)", however the proposed rule differs from the FDIC and Basel III methodology in several significant ways that will put credit unions at a competitive disadvantage in relation to the capital requirements for banks. By including interest rate and concentration risk considerations into risk weightings, the NCUA Board veers off the path used by the FDIC and Basel III.

Further, hundreds of credit unions that are currently well capitalized will no longer be if the proposed methodology goes into effect, and will have to adjust their balance sheets by reducing certain types of loans, possibly turning away loans and limiting their ability to meet the needs of the members in our communities in comparison to how they are able to serve them today.

NUMERATOR CONCERNS

There are several issues with the numerator in the Capital calculation. The logic behind subtracting the National Credit Union Share Insurance Fund (NCUSIF) deposit from Capital is not clear. While we note the NCUSIF is subtracted from the denominator as well, subtraction from Capital has a disproportionately negative impact, and since it is not part of Capital to begin with it does not appear appropriate to subtract it, especially since this is a deposit held by the NCUA to cover credit union failures. This asset is refundable to credit unions if they choose to withdraw from the fund, and in fact would be available to meet the claims of credit union members. We believe it should not be part of the calculation for either the numerator or the denominator.

Limiting the Allowance for Loan and Lease Losses (ALLL) to 1.25% of the risk assets numerator appears to be an arbitrary limitation, and importantly ignores the significant impact that creation of a Credit Adjustment Account as a result of a merger can have when Fair Value Accounting is applied. Since the Credit Adjustment is funded directly from Capital at the time of a merger, and in effect constitutes a lifetime ALLL account balance on acquired loans instead of a 1-year loss ratio, this treatment will likely serve as a disincentive for potential mergers when the NCUA seeks to merge troubled credit unions, as it may greatly reduce their Capital. We consider it appropriate to include the entire ALLL balance in the Capital calculation.

Similarly, the subtraction of Goodwill and Intangible Assets from Capital for the calculation is also likely to provide a disincentive to mergers since these can be substantial sums, or not, depending on Fair Value Accounting, the methodologies for which are open to widely different interpretations. The impacts of Fair Value accounting can change dramatically from the time a merger is agreed to until its consummation, adding to the uncertainty.

Should the ALLL continue to be limited and Goodwill and Intangible Assets continue to be subtracted from Capital, it is possible that many mergers that could be beneficial from a business and safety and soundness perspective will not occur, weakening the credit union industry's competitiveness and exposing the NCUSIF to greater potential losses. We believe it would be more appropriate to risk weight Goodwill and Intangible Assets at 100% in the denominator.

DENOMINATOR RISK WEIGHTING CONCERNS

Our concerns regarding the proposed asset risk weightings are as follows:

1. Risk weightings for several asset categories exceed the 100% weighting assigned by the FDIC and Basel III for the same categories. We understand this to be the case due to NCUA's inclusion of interest rate and concentration risk considerations in the weightings, posing an inconsistency to the FDIC risk weights. *Weights of greater than 100% for credit unions will result in a lower calculated risk-based capital ratio for a credit union in comparison to a bank that has precisely the same capital and asset structure.* Said differently, given the exact same risk profile, credit unions will be required to have more capital to cover the same risk, which will necessarily limit our ability to grow in relation to banks, or in some cases serve members even as we do today.
2. Logically, on-balance sheet assets without recourse requiring additional investment should in no case be weighted beyond the amount exposed to loss, which is 100% of the asset value.
3. If interest rate risk consideration is to be factored into the weightings, then to be consistent the impact of efforts to hedge interest rate risk should be included in the calculation as well. However, determinations of the severity of interest rate risk require the consideration of a multitude of variables that cannot be simplified into a model as simple as the percentage of total assets. Also, as noted previously, to be consistent with capital ratios for banks neither interest rate risk nor concentration risk should be included in this credit risk coverage measure. We believe that NEV is a better measure of interest rate risk, and that interest rate risk considerations should be excluded from this model.
4. Risk weightings for non-delinquent real estate loans are based solely on concentration risk and ignore loan-to-value (LTV) ratios. In contrast, the FDIC methodology ignores concentration risk and assigns risk weightings based on LTV ratios, underwriting practices and seniority of the lien, which we believe is more appropriate. A mortgage loan with an LTV of 50% should not be treated with the same risk weight as a mortgage loan with an LTV of 100% or more. Risk weightings assigned to non-delinquent consumer loans do not take into consideration whether or not loans are collateralized.

If finalized as proposed, this rule is likely to bring about a host of unintended consequences as credit unions will hastily adjust to this new methodology within a short 18-month window. For many credit unions it will reduce the ability to serve existing members to the extent they are able to today.

The proposal constitutes a significant competitive disadvantage for all credit unions, and confers a huge advantage to banks from the credit union industry's own regulator. It may even serve as a significant inducement for credit unions to consider a conversion to a bank charter.

We urge the NCUA Board to modify the calculation in order to meet its stated goal of imposing capital requirements consistent to those used by the FDIC.

Respectfully Submitted:

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