May 13, 2014

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

Dear Mr. Poliquin,

We at My Community Federal Credit Union appreciate the opportunity to comment on the proposed Risk Based Capital – PCA regulation currently under consideration by the NCUA. As a former NCUA Examiner, I have seen the impact such large pieces of regulation have on credit unions and every day since I left NCUA, I have been working to keep up with the constant barrage of regulations that are aimed at all Financial Institutions. Such regulations tend to have a larger impact on the Credit Union Industry as a whole, when our industry is more conservative than other financial institutions in general.

Some of the regulations are forced on NCUA by the Federal Government, such as Dodd-Frank, which I personally feel is a huge example of governmental over-reach and really impacts the financial institutions that had nothing to do with the Mortgage Crisis of 2008 much worse than it impacts the financial institutions that caused the problem. However, that is a topic for another time. In this case, NCUA is the party that is creating a regulation that will hurt the industry at a time where we are coming off paying for the Corporate Stabilization Act, and are having to deal with regulations from the CFPB, and are still in a very low interest rate environment which has put significant pressures on credit union net margins.

My concerns with the proposed regulation are primarily that it seems to require credit unions to hold larger amounts of capital (higher than those imposed on banks) without giving the credit union the resources necessary to accomplish that. Primarily, it requires a larger amount of capital for things that NCUA deems to be riskier, but credit unions don't have the ability to raise secondary capital like banks do. So we are asked to do virtually the same thing with fewer resources.

Additionally, the regulation discusses a compliance period of 12 to 18 months. This seems like a very short time, when the decision to restructure your balance sheet has broad implications on the profitability of your institution. Sometimes bailing on risk for the sake of bailing on risk is not the wisest move. For example, if you look at selling off investments, or mortgages that are strong in earnings in our current environment because they are going to have a larger impact on your Risk-Based Capital requirement, you could be making a huge mistake if you don't consider the "relative value" of the assets you are selling and the opportunity cost associated with that decision.

I recently viewed a webinar of a very prominent Economist/Strategist who recommended that credit unions understand that if you are going to sell or divest of something earning you 4% today, that you would have to find something earning over 8% to make up for the lost income over a three year period (in this market, that doesn't exist). I could be wrong on the actual figures, however the idea is still relevant: You don't want to get rid of something that is doing well for you without understanding the impact. I fear that many credit unions will make rash decisions that will have a negative impact on them just because of the regulatory fear of PCA and the desire to stay a "Well-Capitalized Credit Union". In my opinion a short timeframe for implementation might result in some poor decisions; a window of 3 to 5 years seems to be more reasonable to allow credit unions a well thought out decision that will protect them and the industry.

To me, there is a similarity between this regulation and the 17/4 test that NCUA came out with to assess credit union's Interest Rate Risk. The 17/4 test takes a broad look at Interest Rate Risk by assessing what NCUA deems to be the assets that carry more interest rate risk. However, my experience as an examiner was that in almost every case when you drilled down into the assets and completed the pricing tables, the risk was much less than the initial impression. I think it is likely that with this regulation, we will find that many credit unions' actual risk versus the risk that the model shows is actually lower, which brings me to another point. The regulation indicates that the examiner will have the ability to increase the capital requirement for any credit union. My concern is that it doesn't mention the ability of the examiner to also decrease the capital requirement as well. It is my experience as I mentioned with the 17/4 test above that in many cases a look without drilling down is much worse than it is when they get into the meat of the issue. Any ability for an examiner to require additional capital should also have a corresponding ability to require less capital, but this should not be subjective. There should be clear standards spelled out that consider all seven risk areas and the credit unions risk mitigation plans. Actually, the entire process must be transparent. The current proposal is not, as NCUA doesn't provide justification for requiring additional capital.

There also seems to be some contradiction in the application of the risk weightings especially when compared to the banking industry. The risk weightings seem to be more concerned with Interest Rate and Concentration Risk. However, we already have regulations and guidance to address both. Some examples include:

1. Mortgage Loans vs Mortgage Backed Securities: The risk weightings should not be higher for a Mortgage Backed Security with no credit risk than they are for Non-Delinquent 1st Mortgage Real Estate Loans. Depending on the maturity of the investment, they are risk-weighted as much as 4 times the weight given to First Mortgage liens, which have both credit and interest rate risk.

2. NCUSIF: The NCUSIF is removed from both sides of the equation, however there should be 0 risk, and it is required by NCUA. Also, as credit unions aren't given a choice of how to invest these funds; it should at least be included in the numerator.
3. Goodwill: If GAAP requires recognition of value on Goodwill, then why is none given in this calculation?
4. Member Business Loans: The risk requirements don't take into consideration the credit union's history in making such loans, or loan to values, terms, or any other underwriting attributes.
5. Perpetual Capital: A 200% risk weighting on Perpetual Capital in Corporate credit unions seems a little high.
6. CUSO Investments: A risk weighting of 250% for investment in a CUSO seems egregious especially when the risk weighting is assigned to the value of the investment. If the CUSO does well and increases in value, it seems that the risk weighting should be reduced. Otherwise, there is little to no incentive for credit union collaboration and shared services, which will likely lead to additional mergers and consolidations within the industry as well as decreased competition for banks.

My final concern is that the risk ratings seem to be such that they will negate growth strategies for credit unions. The risk ratings seem to penalize credit unions for Business Lending, CUSOs, selling mortgages and retaining servicing rights, and other services that the credit union industry as a whole has been behind the curve in developing, thereby giving consumers less choice and higher fees. I don't believe that it is good for the industry to enact regulations that limit the industry's ability to compete with banks and provide more financial solutions to the public.

While I do agree that a Risk Based Capital regulation is necessary, I believe that the regulation proposed will serve to hurt the credit union industry as it will have the unintended consequence of stifling growth strategies, and limiting lending and investment options for credit unions, and reducing the financial institution choices for the American Consumer. I would recommend that NCUA use the model for Basel III as a guideline for the individual risk ratings and use a Risk Based Net Worth requirement closer to 9% rather than 10.5%, and also allow a longer compliance time period such as 5 years, rather than 12 to 18 months.

Sincerely,

Mark T. Williams
Chief Financial Officer
My Community Federal Credit Union