CREDIT UNION
westerra

May 21, 2014

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

Re: Comments on Proposed Rule: Prompt Corrective Action – Risk-Based Capital

Dear Mr. Poliquin,

Thank you for the opportunity to provide comments on the above referenced proposal to amend NCUA regulations regarding prompt corrective action to replace risk-based net worth requirements with new risk-based capital requirements. Westerra Credit Union ("Westerra") is a community-based credit union serving over 90,000 members in the greater Denver metropolitan area, with approximately $1.27 billion in assets and a net worth ratio of 11.99%.

Westerra supports the NCUA's efforts to reform risk-based capital for credit unions. We believe though, that such reform must appropriately balance the need for higher capital levels at credit unions with higher risk exposures with the fact that there are statutory limitations on supplemental forms of capital and that credit unions overall performed well through the most recent economic crisis. Since credit unions do not have access to supplemental forms of capital, complying with the new risk-based capital requirement could result in credit unions having to limit lending thus reducing availability of credit for consumers and small businesses. This would be detrimental to long term economic growth and is not consistent with the mission of credit unions to provide access to affordable credit to consumers.

The NCUA's current proposal for a risk-based capital requirement has several flaws which have the potential to negatively impact the ability of all credit unions to maintain and build long-term strength of capital. Below are several areas of concern and possible alternatives for the NCUA Board's consideration.

Well-Capitalized versus Adequately Capitalized Standard

The proposal establishes a *well-capitalized* threshold for risk-based capital; however the Federal Credit Union Act references only an *adequately capitalized* standard. The National Credit Union Share Insurance Fund (NCUSIF) performed well during each of the past two financial crises, and the NCUA has provided no evidence that the higher standard proposed by the new rule would improve upon the safety and soundness of the NCUSIF, or that this standard is even permissible under the Act. Westerra recommends that risk-based capital standards be established relative to the adequately capitalized measure as provided under the Act.

Working For You

Risk Methodology to Assess Interest Rate Risk, Credit Risk and Liquidity Risk

The Federal Credit Union Act directs NCUA to establish a risk-based net worth system which accounts for all material risks at credit unions. The current proposal applies a system of escalating weightings for increased concentrations to assess risk. While this approach effectively makes use of existing Call Report data (with some modifications), it does not accurately assess credit, liquidity and interest rate risk.

- Credit risk cannot be effectively measured by portfolio concentrations alone. The quality of a loan portfolio is the most significant determinant of potential risk to capital.
    - Westerra's mortgage loan holdings consists almost entirely of high FICO, low LTV loans, which would pose significantly less overall risk to capital than a portfolio of low FICO, high LTV loans at a similar sized institution. The current proposed calculation though would not account for the difference in risk between these two portfolios. Instead of focusing on concentrations, the proposed rule could more effectively account for credit risk by differentiating real estate loan risk weightings based on loan-to-value and/or credit scores at the time of origination. In addition, real estate loan interest rate risk would also be more effectively assessed based on fixed versus adjustable rate loans, instead of portfolio size as a percentage of assets.
    - Consumer loans are assigned a higher risk weighting than real estate loans. Consumer loans typically carry lower interest rate risk, liquidity risk and varying credit risk levels depending on credit scores and underwriting practices. It would seem to be more appropriate to differentiate consumer loan risk based on credit scores ranges at the time of loan origination.

- Interest rate risk and liquidity risk can only be appropriately assessed by looking at the entire balance sheet, and not by focusing solely on concentrations in short versus long term assets. The proposed rule does not take into consideration the liability side of the balance sheet which is actively used to manage interest rate risk and liquidity risk. For example, Westerra manages risk from longer term mortgage holdings through a combination of FHLB borrowings, longer term member deposits (CDs), maximizing core deposits, and having adequate borrowing facilities. By focusing solely on concentrations by asset class, and not factoring in the liability side of the balance sheet, the proposed risk-based capital requirement does not take into consider a key aspect of managing overall risk to capital. Consideration should be given to incorporating liability management components as a reduction to risk assets.

Risk Weightings

- The proposed weights for residential mortgage loans and member business loans do not appropriately reflect the historical performance of these loans at credit unions. On a weighted average basis, the proposed risk weightings would be greater for both categories compared to similar Basel III weights. However, credit union loss rates on these loan types have typically been *lower* than at banks.

- Inconsistencies in investment risk ratings exist in the proposal. Under the proposal, a 3 year FNMA mortgage-backed security would carry a 50% higher risk weighting than would a 30 year mortgage loan, even though the FNMA holding carries little to no credit risk and generally carries lower interest rate risk. In addition, U.S. Government obligations are assigned a zero risk weight regardless of term, while overnight federal funds are assigned higher than a zero risk rating. This could result in credit unions investing in long-term fixed rate Treasury securities so as to positively impact risk-based capital and to drive income, instead of holding the funds in overnight funds, thus increasing both liquidity and interest rate risk.

- Mortgage servicing rights are assigned a 250% risk weight which is out of proportion with the risk. The risk with mortgage servicing rights comes from declining values during a period of falling interest rates. We are not aware of any credit union that has suffered a material impact to its capital as a result of declining mortgage service right values. In addition, this high risk weighting may discourage credit unions from selling mortgage loans, thereby taking on more interest rate risk by holding more fixed rate real estate loans. The risk weighting for mortgage servicing rights should not exceed 50%.

- The proposal applies a 250% risk weighting to Investments in CUSOs which is significantly higher than most other asset classes, including loans, and is therefore out of proportion with the risk. NCUA has noted that CUSOs were evaluated similar to a bank's investment in non-publicly traded equity securities when determining the applicable risk weighting. However participation in a CUSO is typically fundamentally different from a bank's equity investment in business purpose, organization and ownership structure. The goal of a shared resource CUSO is not to generate dividends but instead to promote operational efficiencies through cost-sharing and/or access to shared services, or specialized competency. A risk weighting of 250% may actually discourage credit unions from pursuing shared resource CUSOs, when the industry could benefit from them. Accordingly, we believe the risk weighting for CUSO investments should not exceed 50%. If there are in fact CUSO types that have a track record of losses, we encourage you to differentiate the risk weightings for higher-risk CUSO types.

  In addition, wholly-owned CUSO's should be treated differently than CUSO Investments in an outside entity. With a CUSO that is a wholly-owned subsidiary of the credit union, there is no need to assign any risk weight to the unconsolidated investment in CUSO amount. Rather, the CUSO assets that remain after consolidation should be appropriately subject to risk weighting. The proposed regulation should therefore be changed so that only consolidated basis Investment in CUSOs should be subject to risk weighting. This would mean there would be no Investment in CUSO amount for a wholly-owned subsidiary included in risk assets.

The above are a few examples of how risk weightings in the proposal are inconsistent and do not accurately reflect risk to capital. All risk weightings should be re-assessed to ensure they are appropriately aligned to reflect actual risks to capital.

Allowance for Loan and Lease Losses (ALLL)
The ALLL is an element of capital in the proposed regulation but it is limited to 1.25% of risk assets in how much can be included in the capital calculation. If, as anticipated, the Financial Accounting Standards Board moves forward with the current expected credit losses (CECL) accounting standard, most credit unions' capital will be reduced as a result of having to increase their ALLL. Estimates are that financial institutions will have to increase their ALLL by at least 50% under this new accounting standard. The 1.25% of risk assets limitation will mean a significant portion of the ALLL will be excluded from capital. We encourage you to eliminate any limitation on the amount of the ALLL that is included in capital.

Goodwill

Goodwill is treated as a deduction from capital and assets in the proposed regulation. Westerra holds approximately $4.1 million in Goodwill as a result of one merger. The current proposed treatment of Goodwill results in an overall reduction to Westerra's risk-based capital level of 42 basis points compared to when it is not deducted from both components. Goodwill is not included in capital and is not included in the risk weighted assets so why Goodwill is deducted from both is not clear. The impact of this treatment of Goodwill will likely discourage credit unions from taking on troubled credit union mergers due to the negative impact to capital. This will raise the cost of resolving troubled credit unions which will negatively impact the whole credit union system. We encourage you to not treat Goodwill as a deduction from capital.

NCUSIF Capitalization Deposit Treatment

NCUA has indicated that the NCUSIF deposit is considered to be capital of the fund and not credit union capital available to cover losses and is therefore excluded from the calculation by deducting it from capital and assets. This reduces Westerra's risk-based capital ratio by 103 basis points compared to when it is not deducted from both components. The NCUA has stated that this treatment would not alter the accounting treatment for credit unions. However, if the risk-based capital calculation fails to acknowledge the value of the deposit to credit unions then auditors may likely require all credit unions to write-off the value of that investment, thereby negatively impacting net worth across the entire system. We encourage you to not treat the NCUSIF Capitalization Deposit as a deduction from capital.

NCUA Authority to Impose Increased Minimum Capital Requirements

This provision is overly broad and vague, resulting in a high potential for inconsistent application by individual examiners. It also fails to adequately account for the inability of credit unions to access supplemental capital to comply with any additional requirements which might be imposed. Although the proposal would establish a process under which a credit union could challenge a higher capital requirement, we believe this process places undue burden on credit unions and fails to adequately address consistency of application. We recommend that this provision be removed from the proposal and concerns with individual credit union capital and risk levels be addressed through the examination process and existing authorities. If not removed from the regulation, at a minimum, the language should be modified to ensure this authority is managed within a strict system of standards and accountabilities.

Implementation Timeframe

The NCUA has suggested an eighteen month implementation time period; however, this does not align with planning best practices which generally call for a three to five year planning horizon. Westerra currently has in place a three year strategic business plan. Revised risk-based capital requirements could necessitate changes to the current strategic plan which could require the identification and implementation of revised strategies necessary to continue to meet the long term growth, profitability and net worth goals established by our Board of Directors. With many credit unions experiencing a reduction in their "capital cushion" under this proposal, credit unions will need adequate time to react and respond, especially since we do not have access to supplemental forms of capital. We recommend an implementation time frame of at least five years, which is still less than the nine years that small banks were provided to implement the Basel III requirements.

Westerra supports NCUA's efforts to reform risk-based capital requirements. However we recommend that substantial revisions be made to the current proposal to prevent significant and long-term detriments to the industry. It is in the best interests of credit unions, credit union members, NCUA and the NCUSIF to have an appropriate risk-based capital regulation that encourages sound risk management while also positioning the credit union industry for success for the benefit of its members.

Thank you for your consideration of these comments. If you have any questions, please feel free to contact us.

Sincerely,

Betsy H. Guerrero
Chief Financial Officer

Jennifer Meyers
Senior Vice President of Finance