May 22, 2014

Mr. Gerard Poliquin
Secretary, NCUA Board
1775 Duke Street
Alexandria, VA 22314-3428

**RE: Comments on NCUA's Risk-Based Capital Proposal**

Dear Mr. Poliquin:

Boeing Employees' Credit Union ("BECU" or "Credit Union") appreciates the opportunity to comment on NCUA's risk-based capital proposed rule ("Proposal") that was published in the Federal Register on February 27, 2014. This Proposal is one of the most significant rules that the NCUA has recently put forward, and we believe if adopted as proposed, it will have far-reaching and adverse consequences for the entire credit union industry.

BECU has studied the Proposal carefully and offers the comments set forth below. We are encouraged that Chairperson Debbie Matz of the NCUA has stated that the agency is open to credit unions' suggestions for refining the Proposal. As a result of that positive assertion, we are hopeful that the potentially severe and disparate impacts of the Proposal compared to the existing Basel risk-based capital regime will be addressed if a final rule is pursued. We urge NCUA to rethink its need for the rule or at the very least redraft so it does not impose more stringent requirements that inhibit credit unions' ability to serve their members and communities.

## I. Background

BECU is a Washington State-chartered, federally insured credit union headquartered in Washington State. BECU currently has assets of nearly $13 billion and is the fourth largest credit union in the country. BECU's beginnings, like most credit unions, began humbly when 18 Boeing Company employees pooled their money during the Great Depression to create the credit union (and a source of funding to residents in the greater Seattle area) in 1935.[1] The fact should not be lost that BECU and many other credit unions came into existence in response to the systemic and colossal failures of the banking system during this traumatic time.

Because BECU has always taken its financial responsibilities seriously and performed in a safe and sound manner, the Credit Union has successfully weathered and even thrived during desperate financial times, including the Great Depression and the recent Great Recession. For 79 years, BECU has been a stable and stalwart presence in western Washington (more specifically, the "Puget Sound" region of Washington) providing financial products and services to individuals and small businesses in our community.

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[1] Each of the 18 original founders contributed 50 cents accounting for total beginning assets of $9.

While it is true that some credit unions failed during this most recent financial crisis, including the failure of three corporate credit unions, the number of retail credit union failures totaled only 78[2] compared to 464[3] bank failures during this period. This important statistic underscores BECU's belief that the Proposal is not necessary as proposed.

## II. General Comments

BECU supports the NCUA's efforts to improve the current risk capital framework. A strong capital framework can, if properly designed, serve to strengthen the financial system so that it can better withstand the effects of inappropriate risk-taking activities. We recognize the considerable challenges of developing a system that adequately addresses inherent risks across an entire industry. However, BECU believes that the Proposal exceeds the authority granted the NCUA under the Federal Credit Union Act (12 U.S.C. 1790d(d)(2)) and that it will unnecessarily burden the credit union industry, making it more difficult for credit unions to serve their members and prosper in the face of stiffening competition.

The NCUA states that the purpose of the Proposal is to:

> … amend NCUA's regulations regarding prompt corrective action (PCA) to restructure [Part 702], and make various revisions, including replacing the agency's current risk-based net worth requirements with new risk-based capital requirements for federally insured 'natural person' credit unions.

The Proposal indicates that the new risk-based capital requirements will be:

> … more consistent with NCUA's risk-based capital measure for corporate credit unions and the regulatory risk-based capital measures used by the Federal Deposit Insurance Corporation, Board of Governors and the Federal Reserve, and the Office of the Comptroller of Currency … .

BECU believes, however, that the Proposal is highly inconsistent with the Basel III standards for banks. While we understand that there are both structural and operational differences between banks and credit unions, we believe the differences between the capital frameworks in Basel III and the Proposal are not warranted based upon the relative historical performance of bank and credit union portfolios.

The NCUA's 10.5% minimum capital requirement outlined in the Proposal includes a 2.5% capital conservation buffer that unnecessarily increases credit union capital requirements. The FDIC will require a capital conservation buffer of 2.5% for banks once fully implemented in 2019; however, the concept of a capital conservation buffer was developed to ensure that banking organizations retained capital when it was most needed. If banks do not hold the 2.5% buffer, restrictions will be placed on their ability to pay stock dividends or buy back shares. This concept does not apply to credit unions as we do not return capital to shareholders through equity dividends or stock buybacks. The NCUA's proposed 10.5% minimum capital requirement

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[2] Source: Failedbankreport.com

[3] Source: Bankrate.com

imposes materially higher capital requirements that put credit unions at a disadvantage to banks without any empirical justification.

The Federal Credit Union Act ("FCUA") states that risk-based capital requirements should "take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection." As a result, NCUA states that one of its goals for the Proposal was that "the [risk-based capital] requirement should address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk." BECU does not believe that the FCUA requirement was intended to cover the expansive range of risks identified in the Proposal, particularly when one considers the fact that the FCUA also requires the NCUA's PCA regime and capital requirements to be "comparable" with those applicable to banks. 12 U.S.C 1790d(b).

Our specific recommendations on the Proposal are outlined below.

## III. Risk-based Capital Ratio Measures (Part 702.104)

In the Proposal, the NCUA assigns each asset a specific risk-weight. The risk-weights, however, are inconsistent between and within asset classes. (BECU discusses this issue in more detail in the relevant sections of this letter.) Furthermore, although NCUA says the rule is motivated in part by the Basel standards, several categories of risk ratings are inconsistent with bank weightings now in effect. For example, depending on the amount of real estate loans on the balance sheet, a credit union could be required to hold a higher percentage of capital for these loans even though its loan quality has been significantly better than banks as far back as numbers are available. This disparity could strike at the heart of credit unions' ability to support the housing finance needs of their members and communities in the future.

BECU is concerned, in particular, that the Proposal does not justify the risk weightings or describe how the risk weightings were derived, or how they are relevant to the credit union industry's historic or current risk levels.

Furthermore, BECU believes that the risk-weights in many cases do not accurately capture the risks associated with particular assets. For example, regarding non-delinquent first mortgage real estate loans, BECU believes that the proposed risk-weights are too high and, in effect, penalize credit unions for concentrations of loans that are not demonstrated to involve excessive levels of risk.

Internal inconsistencies are evident in the Proposal. For example, Treasury bills and U.S. government obligations have a zero percent risk weighting, but a deposit in the Federal Reserve, which prints the money and pays the government's debt, has a 20 percent risk-weighting.

Although the NCUA states that the Proposal is intended to modify the calculation method for computing NCUA's current risk-based net worth ("RBNW") requirement to make it more consistent with the risk-based capital measures used by the other federal banking regulatory agencies,"[4] the fact is that the proposed risk-weights are not the same as those applicable to

[4] NCUA Proposed Rule, p. 11187.

banking institutions. Indeed, they are higher, at least as they apply to non-delinquent first mortgages and member business loans. These disparities are not justified by the relative performance of these portfolios between the banks and credit unions, making the Proposal not comparable to the Basel regime as required by the FCUA.

Basel III has higher risk weights for a number of asset classes including non-delinquent first mortgage real estate loans which are risk-weighted at 50 percent regardless of concentration limit. So, if NCUA is modeling its Proposal to conform more closely to the Basel III standards, BECU questions why certain risk-weights for certain assets are different from Basel. BECU believes the inherent loss methodology underlying the federal banking capital framework is sufficient to capture the "material risks" not covered by the NCUA's current net worth ratio requirements.

### A. Investments

The risk weights assigned to investments in the Proposal are noticeably lower than the existing RBNW guidelines; however, they are considerably more punitive than the risk-weightings that Basel III assigns to investments.

The Proposal assigns different risk-weights based on the weighted average life (WAL) of investments. The NCUA does not fully rationalize in the Proposal how it determined these risk-weights and, consequently, the risk-weightings assigned appear to be arbitrary. A misguided assignment of risk-weighting could have unintended and adverse consequences. For example, the Proposal does not apply a WAL penalty to direct obligations of the U.S. government. This could motivate credit unions to extend the maturities on their U.S. government obligations, even when shorter maturity GSE investments can provide potentially the same or increased levels of income with lower interest rate risk and minimal credit risk.

In addition, as noted above, it appears that the NCUA is trying to address interest rate and liquidity risk in addition to credit risk in its investment risk-weightings. Basel III does not incorporate interest rate risk into the investment risk-weights. Instead, Basel III generally weighs the investments that banks can make with a single risk-weight regardless of maturity. Basel III also credits institutions for certain risk mitigation efforts, such as the use of derivatives, which have the effect of offsetting some of the exposure to interest rate risk.

Interest rate risk is already subject to other forms of regulatory guidance from the NCUA and State Supervisors. If the NCUA insists that the new rule address interest rate risk, the NCUA should include a provision in the final rule that factors in appropriate interest rate risk mitigation steps undertaken by a credit union. Credit unions already monitor and control for interest rate risk through their own Board-level policies, and Board or Asset Liability Committee actions, subject to the NCUA's and State Supervisor's examination and supervision authority.

It is clear that NCUA has already regulated interest rate risk matters when, in 2010, it required credit unions to create a board-level policy that identified ways in which credit unions must control interest rate risk and, then again more recently, when it approved a rule authorizing credit unions to engage in limited derivatives transactions for the purpose of mitigating interest rate risk. Consequently, BECU believes that there is no need for NCUA to address the subject of interest rate risk, at least as it applies to risk-weights for investments, for purposes of risk-based capital planning. We recommend that the risk-weights for all classes of investments be consistently applied based on the inherent credit risks associated with individual classes of investment.

### B. Non-Delinquent First Mortgages

The Proposal compensates for perceived concentration risk in non-delinquent first mortgage real estate loans by increasing the risk-weightings as such loan portfolios increase as a percentage of assets, from a risk-weight of 50% at the low end to 100% at the top. If NCUA's modifications to the risk-weights were adopted, many credit unions will be compelled to rebalance their asset base, ultimately impairing their ability to meet the housing finance needs of their members and resulting in significant opportunity costs. Basel III, on the other hand, weights non-delinquent first mortgage real estate loans at 50 percent regardless of the concentration in the portfolio.

The Proposal's risk-weights do not take into consideration any factors that could indicate that the loans are more or less likely to default, such as the loan-to-value ratio of loans or credit scores of borrowers. These credit risk factors chould be used to lower the amount of capital required to be held for loans that are safer than others.

In light of the fact that the Dodd-Frank Act imposed numerous new regulations on first mortgage real estate loans (including enhanced underwriting standards and the introduction of "qualified residential mortgages"), many of which have already been implemented, we believe that the credit risks associated with these products have already been significantly mitigated.

BECU recommends the removal of the concentration buckets so that the new risk-based capital rules mirror Basel III and still appropriately capture the risk associated with the loans. We also would recommend that the NCUA bucket the loans based on appropriate credit risk criteria, such as whether the loans are qualified (or non-qualified) residential mortgages, or interest-only loans, have balloon payments, etc.

Finally, we would like to see the risk-weightings of other real-estate secured loans aligned with Basel standards by removing the concentration buckets and risk-weighting everything at 100%.

### C. Member Business Loans

The Proposal maintains the same concentration buckets for assigning risk-weights as the current RBNW rule, which means that the first threshold applies to concentrations between 0 and 15 percent. The second threshold applies to concentrations over 15 percent and up to 25 percent. The third threshold applies to concentrations in excess of 25 percent. However, the Proposal increases all of the risk-weights for MBLs.

BECU believes that high concentrations of member business loans should not necessarily have such high escalators. There is already a 12.25% cap that cannot be exceeded without approval from the NCUA or State Supervisor, as appropriate. Most credit unions are not close to the cap. The cap should provide a basis for necessary examination and supervisory oversight related to MBL concentrations.

Furthermore, the minimum proposed risk-weight is equivalent to a delinquent first mortgage. We have difficulty understanding how the two can be viewed as presenting similar levels of risk. BECU recommends that the risk-weights on member business loans be tied to the underlying collateral type, which is a better representation of the credit risk profile of the loan.

### D. Individual Minimum Capital Requirements

We have serious concerns with the theoretical and operational elements of this section and we urge NCUA to remove it from the Proposal. As currently drafted, this section provides NCUA with complete discretion, unchecked by a requirement for consultation with the State Supervisory authority in the case of a state-chartered credit union, to demand higher capital levels from any credit union at any time. We believe agency discretion should be controlled by clear standards, delineated administrative processes, and a robust appeals process, all of which are lacking in this section of the Proposal.

### E. Implementation Period

The Proposal has an implementation period of 18 months after the final rule has been adopted. The implementation timetable is not long enough for a rule with such broad impact on credit unions. During that period, many credit unions would need to assess the impact and make extensive adjustments to their strategic plans, systems, balance sheets and operations for the new requirements. In contrast, the banking industry will have many years to implement the Basel III standards, as these standards are not effective until 2019.

Making the adjustment even more difficult, of course, the NCUA does not currently recognize the ability of most credit unions to offer supplemental capital accounts to meet regulatory capital requirements. The only way credit unions can build capital is through retention of earnings, a process that can take considerable time.

BECU believes that any implementation period should be no less than three years after a final rule is adopted, to allow regulators and regulated alike a reasoned and prudent transition to the new rules.

### F. Supplemental Capital

NCUA's failure to include supplemental capital for non-low income retail credit unions within its proposed risk-based regulatory framework is unfortunate and disappointing. NCUA should allow all credit unions to utilize supplemental capital to meet the new risk-based capital standards.
NCUA's contention that it lacks the authority to approve supplemental capital for the risk-based capital ratio is an unnecessarily narrow reading of the FCUA. That NCUA has chosen to so narrowly construe their legal authority in this instance is puzzling given the agency has taken a generous interpretation of the FCUA both within this rulemaking and in previous rulemakings.

NCUA's narrow interpretation of the FCUA is articulated not in the proposed rule, but rather in a recent letter to Congress. In the letter, NCUA cites 12 U.S.C. 1790d(0)(2) as limiting what may be counted as net worth in a non-low income credit union. However, this section addresses "net worth" for purposes of calculating the statutorily required "net worth ratio." Neither of these terms, and hence the cited statutory definition, are dispositive for risk-based capital. As proposed by NCUA, credit unions will be required to meet two standards: the explicit statutory net worth ratio and then the proposed risk-based "capital ratio."

The term "capital ratio" appears nowhere in the current statutory construction cited by NCUA as limiting its ability to broadly include supplemental capital. Put more simply, NCUA is introducing an entirely independent capital measure into the prompt corrective action construct. Nothing in existing credit union law or regulation speaks to what constitutes the new "capital ratio" standard. Because Congress did not speak directly to what may constitute the "capital ratio," NCUA need not be limited by §1790d(0)(2) in defining what constitutes the "capital ratio" elements. Such a broader interpretation of the FCUA is well within both the "reasonableness" and "rightness" standards by which an agency's interpretation of its authorizing statute is judged under relevant case law. NCUA has chosen to read the applicable FCUA provisions broadly for its authority to issue this rule, and it should read the authority to include supplemental capital in the same permissive light.

## IV. Conclusion

In summary, BECU does not support the Proposal as drafted. While BECU understands NCUA's desire to address potential weaknesses in the existing RBNW framework, we believe that the Proposal exceeds the authority granted to the NCUA under the Federal Credit Union Act (12 U.S.C. 1790d(d)(2)) and that it will unnecessarily burden the credit union industry, making it more difficult for credit unions to serve their members and communities.

If NCUA feels compelled to revise its current RBNW rule, BECU strongly advocates that the NCUA consider revising the Proposal to correct the deficiencies noted above.

A longer phase-in for implementation should be incorporated so that credit unions will have the time to make the necessary adjustments. The banking community will have more than five years to implement the Basel III accords, and yet credit unions, which will be equally if not more impacted by the NCUA's Proposal, will have only 18 months at best to comply with the new requirements.

Thank you for considering BECU's comments on the Proposal.

Sincerely,

Benson Porter
President and Chief Executive Officer
BECU

Kathy Elser
Chief Financial Officer
BECU