May 22, 2014

Eli Lilly Federal Credit Union
225 S. East Street, #300
Indianapolis, IN 46202

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

Dear Mr. Poliquin:

I am writing this letter on behalf of the Eli Lilly Federal Credit Union Members, Board of Directors and management regarding the NCUA's PCA Risk-Based Capital proposal issued January 2014.

Our credit union shares the NCUA's objective of protecting the Share Insurance Fund and promoting sustainable, long-term strategic practices to improve the image and strength of the credit union industry going forward. In 2009 we became painfully aware of the shared risk within the industry and would prefer not to repeat that exercise.

Eli Lilly Federal Credit Union appreciates the transparency of the Risk-Based Capital calculator the NCUA provided, which assisted our organization to better understand exactly what the Agency considered high- and low-risk.

The proposed Risk-Based Capital rule raises several issues that require deeper collective conversation within the industry. This communication will focus on four items of concern:

- Risk Weightings: Rationale and changes
- Timing of rule phase in
- Unlimited discretionary powers to establish Individual Minimum Capital Requirements
- The additional regulatory burden

I will add some color to each of the points listed above.

Risk-Weighted Factors

It appears the NCUA is attempting to create a formula that melds interest rate risk, credit risk, and concentration risk – no small order. Credit Unions are already performing analysis and managing their balance sheets to address these risks, so how does the new rule improve upon the work that is already being performed? While the calculator acts as an estimate, it will be viewed as the hurdle that must be cleared by both Examiners and credit union management. Some of the risk-weighted factors do not seem to make sense: a 30-yr fixed rate 1st Mortgage loan carries the same weight as a 3/1 ARM.

The methodology used for the investment portfolio appears to be focused on the NCUA's perception of interest rate risk and to a lesser degree, credit risk. The NCUA's version of the Investment factors seems rather harsh as well as inconsistent. Should an investment with a 2-year average life have the same factor as the first tier of first mortgage loans (each could be at 0.5)? If a 30-year first mortgage loan carries a factor of 0.5, it seems the factor on a 2-year investment should be a lower figure.

If a credit union is pressed to lower the life of the investment portfolio, there will be actual earning ramifications. An investment with an average life of 5-years provides a yield of approximately 100 basis points more than an investment with a 2-year life. Over the course of a year, this is the equivalent to $100,000 on a $10 million investment. Credit unions need to drive revenue through their investments – the portfolio is generally very conservative from a credit perspective. The new rule, as proposed, will drive yields down and force credit unions to charge higher fees and/or take credit risk within the loan portfolio.

As credit unions work to manage their shops to a particular hurdle, I find it likely the NCUA will change or alter the factors over time. While we can poke at numerous inconsistencies within the risk-weights, the NCUA likely cannot argue with any degree of certainty how or why the factors are correct. It is possible that any changes made to the factors in the future could have a positive or negative impact to credit unions. However, as the rules change, credit unions may spend more time working to manage to a complex ratio rather than working to provide value-added services to the membership. The regulatory burden may outweigh any perceived gains related to safety and soundness because our eye may be distracted from what we are chartered to do – serve our members.

The risk-weighting for credit unions should be lower than the risk weights for commercial banks for comparable products. Historically, credit union loan losses have been significantly lower than bank rates, so from a credit perspective, it makes sense to reflect this difference in the form of a lower risk-weight for credit unions.

The 2.5 risk-weighting assigned to investments in CUSOs seems excessive. There is no distinction made as to the nature of the CUSO operations being evaluated, nor to the dollar level of investment. This seems entirely arbitrary as the NCUA has not provided historical support within the proposal for the risk-weight. CUSOs have been utilized by credit unions for numerous years as a way to provide expanded value-added services to members in both a cost-effective and profitable manner.

One last thought on risk factors – no consideration is given to the deposit side of the balance sheet. There is no credit given for having stable deposit balances and/or the protection that core deposits offer. Our organization believes this is a significant oversight on the part of the Regulator.

Timing of Rule Phase In

Credit unions will have a relatively short time to adjust to the new rule. It may require more than 12-18 months for many credit unions to redirect their balance sheet to conform to the new standards without having to sacrifice yield and/or earnings.

Eli Lilly Federal Credit Union urges the NCUA to either allow additional time for the new rule to take effect or create a “phase-in period” that methodically moves the standard to the final figure over the course of several years. This will allow credit unions to make the necessary adjustments without having to sell off certain “risky” assets at a disadvantaged position.

Individual Minimum Capital Requirement

The NCUA included a provision within the current draft to allow the NCUA to assume additional authority to impose even higher capital requirements on individual credit unions that could exceed even well-capitalized requirements. As an example, the NCUA indicates higher capital may be appropriate for a credit union that has significant exposure to declines in the economic value of its capital due to changes in interest rates. This is a significant concern as NCUA Examiners have varying levels of ALM expertise and personal bias could influence the decisions.

Providing NCUA examiners with the ability to increase capital requirements without the benefit of what most credit unions would consider a fair and objective appeal process is unacceptable. Credit unions are uncomfortable with the prospect of unilateral judgments by examiners with (potentially) no hands-on management experience.

The new rule, as proposed, sends a message to credit unions that “the rule may not work very well for some credit unions, so the NCUA will change the rules as it sees fit.” If the rule doesn’t work, why should it be implemented? Our credit union is opposed to creating a rule that already has a built-in workaround: by creating the IMCR provision, the Regulator has already conceded the proposed rule may not work well.

Regulatory Burden v. Member Focus

NAFCU has performed calculations that show credit unions will need to carry an additional $6.3 billion in capital to remain well-capitalized if the rule is passed in its current form. CUNA estimates over $7 billion in additional capital will need to be withheld by credit unions rather than putting those dollars to work for the membership in the form of great rates, value-added products, convenience channels, and technology. Representatives from the NCUA have stated credit unions do not have to maintain a large “buffer” above the well-capitalized limit. However, well-run credit unions understand there are risks beyond their control and will always work with a buffer to avoid falling into a PCA category that is below well-capitalized.

Additionally, nearly all the recent communication that comes from the NCUA states the number of problem credit unions is shrinking. The additional Risk-Based Capital hurdle does not seem to provide a significant incremental improvement to manage this issue.

As the concept of risk-based capital gains a higher profile, well-qualified individuals denounce the practice. Thomas Hoenig, Vice-Chairman of the FDIC and former Kansas City Federal Reserve Bank President wrote in The Financial Times that using tangible equity capital and total assets is a more conservative, more credible method of assessing capital adequacy. He states “Each new Basel standard attempts to correct the errors and unintended consequences of earlier versions. But instead of resulting in better outcomes, each do-over has been more complicated and less effective than the last. Unfortunately, the weightings are more arcane than ever, and therefore, even less useful.”

While our organization appreciates the Agency’s efforts to design an all-encompassing matrix to protect the Share Insurance Fund, we are uncomfortable with the risk-weight factors, the timing of implementation, and the ability of the NCUA to change the rules at its convenience. We see no evidence this proposed rule will provide substantial value to the industry. Risk-based capital did not prevent the 2008 financial crisis from happening, as the prominent issue was liquidity. The current system that divides tangible net worth into total assets has been simple and effective. It appears the NCUA has created this rule in response to political arm-twisting.

Our organization values our relationship with the regulator and appreciates the process the NCUA has created to allow individual credit unions to voice concerns related to new rules and regulations.

Thank you for your consideration,

Joseph R. Hasto, Jr.

Chief Financial Officer

Eli Lilly Federal Credit Union

jhasto@elfcu.org

317-524-5051