TAPCO
CREDIT UNION

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May 21, 2014

To: regcomments@ncua.gov

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

RE: Comments on Proposed Rule: PCA - Risk-Based Capital

Dear Mr. Poliquin:

TAPCO Credit Union in Washington State appreciates the opportunity to comment on the National Credit Union Administration (NCUA) Board's proposal to revise Prompt Corrective Action related to Risk-Based Capital. TAPCO has served the Community of Pierce County since 1934. We currently have 23,000 members and $290 million in assets.

TAPCO agrees that from time to time capital standards need to be reviewed to use recent events as a learning tool which may improve the safety and soundness of the industry we serve. However, the current Proposed Rule will have negative effects on our members and discourage investments in long term strategies necessary for our Credit Union to thrive. We ask the NCUA to examine the proposed risk weightings and consider adjustments to the proposal that will allow credit unions to continue to serve their memberships in a safe and sound manner. TAPCO requests that the proposed risk-based well capitalized requirements align closely with the existing net worth requirements which served the industry as a whole well in the recent downturn.

We also request that the time frame to change to a risk weighted system be extended to 48 months instead of the proposed18 months. The shorter timeframe is not realistic for an institution to modify their business model in a prudent manner. Such a rapid shift on the balance sheets of credit unions will not enable a safe or sound transition. The proposal does not consider the value of long term assets in a declining interest rate environment. Long term asset values increase greatly while rates are declining which supports continued profitability for the industry as rates change.

Under the proposed risk-based capital rule, TAPCO will not see its current well-capitalized status change but our business model and long term strategy will change drastically. Management will be forced to reshape the Credit Union's overall business model as it relates to long term investment, lending and expansion strategies. The result will negatively impact the member experience and put the Credit Union at a competitive disadvantage with other financial institutions. The Proposed Rule, in its current state will inhibit TAPCO's business strategy and discourage the Credit Union from investing in branches and new technology.

The review of NCUA rules defining minimum capital requirements and Prompt Corrective Action appears to be timely given the 2007-2009 Great Recession. We believe that any such review should take into consideration the unique characteristics and qualities of credit unions. There is no evidence that risk based capital requirements, utilized by the banking regulators, work any better than the net worth requirements currently imposed by the NCUA.

The CUNA analysis of NCUSIF losses vs. FDIC losses from 2007 to 2013 shows the banking loss rate, with risk-based capital standards in place, was 8.8 times higher than the credit union experience with a simple leverage ratio being used for capital adequacy. During this period the FDIC loss rate was $2.30 per $1,000 of deposits vs. the credit union loss rate of $0.26 per $1,000 of deposits. Banks have had risk-based capital requirements for nearly 25 years and these requirements neither prevented the latest crisis in 2007 nor stopped significant failures in the banking system.

The credit union industry came through the worst recession in history with reduced capital. But, in our opinion, the capital is there to weather such storms and it served the membership well. Our own experience reduced our capital level from 12% to 8% which is still considered well capitalized. If the capital level is not there to be used in environments like the Great Recession then when is it to be used? Using our capital during the downturn allowed us to continue to serve our membership and sustain our growth in the community.

The question needs to be asked, "Is it necessary to implement a proposal where most credit unions will see reduced buffers above being well capitalized?" Most credit union failures, including the Corporates, centered on high concentration levels that are subject to the annual examination process. As opposed to implementing risk-based capital standards that appear to measure interest rate risk and concentration risk unevenly, the NCUA could consider to better define risk weights in combination with the need to improve industry and examiner understanding of risk.

Below are the comments that TAPCO is asking the NCUA to consider in developing the final version of the Risk-Based Capital Rule.

1. **Several of the risk weightings under the Proposed Rule appear to be too general or excessive. Under the Proposed Rule, credit union risk weights would be higher than that of banks requiring credit unions to hold more capital than banks for the same assets. This is a major concern to the industry as it would place credit unions at a competitive pricing disadvantage in an already highly competitive marketplace. In addition, using higher risk weights on long-term assets to deal with interest rate risk is misleading without considering liability maturities.**

<u>Investments</u>
Under the Proposed Rule, investment risk weightings for credit unions are significantly higher than that of banks. The NCUA risk weights appear to be punitive and somewhat inconsistent when compared to banks thus putting credit unions at a disadvantage. All Treasury securities and those securities guaranteed by the NCUA or FDIC carry a 0% risk weight, no matter what the maturity. Other Agency backed securities with no credit risk, such as FMNA and Freddie Mac, are risk weighted based on weighted average life time buckets.

Investments with weighted average lives greater than 5 years are given punitive risk weights of 150% for 5 to 10 year average lives and 200% for average lives greater than 10 years. This compares to 20% risk weightings for similar securities in the banking model.

In addition, a 30 year whole loan mortgage on a credit union's balance sheet would carry a 50% risk weighting while securitizing the same loan into a 30 year FNMA security, with enhanced liquidity, would carry a 150% risk weighting. Credit unions believe the final version of the Rule should more closely mirror bank risk weightings for investments so as not to create such a competitive disadvantage. TAPCO also believes there should be no risk weightings on investments greater than 100%.

Real Estate Loans

Under the Proposed Rule, no distinction is made on the risk weightings assigned to mortgage loans of various maturity and repricing terms. A 30 year fixed rate mortgage gets the same risk weight as a 1 year adjustable rate mortgage and a 30 year fixed rate home equity loan gets the same risk weight as a variable rate home equity line of credit. As opposed to implementing risk-based capital standards that lump all mortgage loans together there should there be more diversity in the risk weighting.

Over the past 4 years, TAPCO has been adding mortgages to its loan portfolio which have 10 year maturities and a loan to value of 50% or lower. Classifying this type of mortgage loan along with a 30 year fixed rate loan for 95% loan to value does not make sense from a risk perspective. As a result of holding 10 year fixed rate mortgages, TAPCO's balance sheet is well positioned for a rising rate environment. The mortgages being held in the balance sheet have short term characteristics which produce strong, stable principal cash flows that limit exposure to rising interest rates. Under the Proposed Rule, there would be no difference between TAPCO's capital requirement for its mortgage portfolio and the capital requirements for a credit union that holds all 30 year mortgages in the balance sheet.

TAPCO believes that the capital requirement for adjustable rate mortgages and shorter maturity fixed rate mortgage loans should be lowered in the final version of the Rule to fairly take into consideration the reduced risk associated with adjustable and shorter term mortgage loan products.

Member Business Loans

The NCUA Proposed Rule creates a weighting in favor of consumer loans as opposed to other assets such as member business loans. Consumer loans are assigned a 75% risk weighting while member business loans are subject to concentration-based tiered risk weights. TAPCO's quarterly reporting shows that the Credit Union's member business lending portfolio is one of the most profitable product lines in the balance sheet.

If the Proposed Rule was to become final, TAPCO may be forced to increase production in lesser quality indirect and unsecured consumer loans rather than higher quality, more secure member business loans in an effort to preserve capital. TAPCO is urging the NCUA to reconsider and remove portions of the Proposed Rule that apply higher risk weights to member business loans based on a percentage of a credit union's assets in that category. A higher MBL concentration is not necessarily a negative. TAPCO is afforded the ability, via a strong portfolio, to retain the expertise needed, as well as invest in servicing programs internally, to successfully run a safe and profitable MBL portfolio.

2. The NCUSIF deposit should not be deducted from the risk-based capital numerator.

The National Credit Union Share Insurance Fund 1% deposit is being ignored in the risk-based capital calculation. The NCUSIF deposit is a valid asset that can be refunded for various reasons including conversion to a bank or savings institution charter, a credit union electing private insurance instead of NUCA or voluntary liquidation. In addition, the deposit can specifically be attributable to a failed credit union providing an additional buffer against NCUSIF losses in addition to the failed credit union's capital.

If a credit union did convert to a bank charter the NCUSIF deposit would immediately be included in the risk based capital numerator. TAPCO recommends not deducting the NCUSIF deposit from the risk-based capital numerator.

3. TAPCO has concerns about the examiner being able to arbitrarily decide if the Credit Union needs a higher capital ratio, even if the calculation indicates the Credit Union is well capitalized.

The Proposed Rule gives the NCUA authority to require a higher minimum risk-based capital ratio for individual credit unions based on NCUA examiner expertise. While our experience with examiners has been positive historically, this creates excessive uncertainty in determining what is well capitalized.

This discretion could lead to inconsistent interpretations and application of the Rule and will lead to mistrust between credit unions and the NCUA. TAPCO strongly recommends the elimination of individual minimum capital ratios from the final version of the Rule.

4. Investments in CUSOs should be risk weighted at 100 percent as opposed to 250% under the Proposed Rule.

TAPCO traditionally has not actively engaged with more than a few CUSOs over the years. TAPCO's involvement with CUSOs may increase the Credit Union's profitability by contributing to increased production and by helping to reduce operating expenses. If TAPCO is a part owner in the CUSOs, exposure is generally limited to the credit union's investment in each of the CUSOs.

The NCUA already limits a credit union's investment in CUSOs, under NCUA Rule 712.4, so we do not need to impose a 250% risk weighting on CUSO investments. TAPCO is concerned that the inflated risk weighting on CUSO investments may hinder collaboration among credit unions at a time when such collaboration is vital to the future success of the industry.

Many credit unions are looking at CUSO relationships as a way to consolidate functions in an effort to reduce operating expenses and to offset declining net interest income and non- interest income levels. TAPCO believes CUSO investments should be risk weighted at no more than 100%.

5. Consideration should be given to increasing the 1.25% allowance limit for adding to the numerator should FASB adopt the Current Expected Credit Loss Model.

FASB's proposed new standard on the allowance will most likely increase normal reserves by an estimated 30% to 100% at some credit unions. TAPCO believes that more of this required allowance should count towards capital should the higher standard be adopted in the near future.

6. Consideration should be given to permit federally insured credit unions to offer supplementary capital.

Credit unions remain the only financial institutions that do not have access to sources of capital beyond retained earnings. If higher capital standards are to be found necessary for the credit union industry under the Proposed Rule, affording credit unions the ability to raise supplementary capital that counts towards net worth requirements seems to be an appropriate policy consideration.

In summary, TAPCO feels the current Proposed Risk Based Capital Rule may be too general and uneven in assigning risk weightings. Focusing on a regulatory model designed to identify concentration and interest rate risk and not member needs, has the potential to override the Board's and Management's judgments on business strategy and risk, while leaving the Credit Union subject to examiner and Agency arbitrary discretion for higher minimum capital limits.

If credit unions are all put in one box, we will develop systemic risk. The industry may be subject to an increasing and widespread failure. The strength of the industry is its varied form of services and delivery systems while its weakness was concentration at the Corporate Credit Union level. The variety of credit union business models worked well in the great recession evidenced by the health of the industry today. The Proposed Rule in its current form may reduce the risks to the NCUSIF, but at a significant cost to the credit union industry and their members through reduced higher-cost residential and member business loans.

In addition, it will place credit unions at a competitive disadvantage as it would require far more capital than what is required for banks, especially when considering a credit union's inability to raise supplemental capital. TAPCO feels that with modifications to the Proposed Rule based on objective criteria, the final version of the Risk-Based Capital Rule could in fact be an improvement over current Risk Based Net Worth.

Thank you for the opportunity to comment on the Proposed Rule and for listening to our concerns. Please feel free to contact me with any questions or comments regarding TAPCO's comments on the Proposed Rule.

Sincerely,

L. Scott Drabb, CPA
VP/CFO

CC: Senator Maria Cantwell
Senator Patty Murray
Congressman Denny Heck
Congressman Derek Kilmer
John Trull, NWCUA Director of Regulatory Advocacy