May 22, 2014

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

RE: Comments on Proposed Rule: PCA - Risk-Based Capital; RIN 3133-AD77

Dear Gerald Poliquin,

South Division Credit Union is a small ($52MM) State-chartered, low-income designated NPCU on Chicago's South Side. We are a diverse membership of low to middle income households, high school educated, blue collar trades and service industry employed, and well represented by a credit union operation that provides us a full array of financial products and services with which to manage our incomes and modestly raise our families. For our size credit union, we understand that we have a more robust operation than other credit unions of comparable size and marketplace situation. But then, we are the third largest credit union in our Chicago metropolitan chapter of 70 credit unions – the largest chapter in Illinois. Our credit union is managed by a progressive Board of Directors and management team who, at our direction, subscribes to a business model of serving Members of modest means with more than modest service. Serving the underserved does not mean under-service.

From this perspective, we firmly believe in risk-based lending and risk based capital and have considerable experience in both. As a LID, even long before this was an official NCUA designation, we have been aware that we are a higher than average loan risk pool due to our lower incomes and education levels. And since 2002, to offset higher than average Member loan losses, we have invested in participation loan pools outside our marketplace as insurance against Member losses. No quite as complex and fancy a hedge against internal loan losses as the infamous pre-recession derivatives, but easy to understand and effective enough to offset our higher risk Member loan losses. The risk of these participation loan pools has proven to be considerably lower, by a quantum factor or more (>1,000:1) than our own Member loan pools.

This risk disparity increased even more as the Recession of 2008 swept through our Membership. High unemployment; under-employment; financial, emotional and

physical stresses on families and individuals; home foreclosures; these were only a few of the complex human circumstances that caused us to lose $1.2MM between 2010 and 2013 because of Member pool loan losses – plus an additional loss of $1MM between 2009 and 2012 to the NCUA Stabilization Fund. The result was a cumulative drop in our net worth from 13% to 10%. And ironically our hedge strategy to off-set these losses with outside loan participations, despite six years' experience of no losses, was systematically shot-down with cease-and-desist orders from NCUA field examination staff that even went beyond participation loans, but mortgages to the Members as well. No quantitative or qualitative analysis was pro-offered. Rather, the personal assessments and beliefs of field staff about

market conditions, the presumption that a credit union our size was incapable of managing this kind hedge strategy, and the fact that we did not have an adequate risk model in place was cited. When queried as to the kind of risk model that would be satisfactory, we were advised to adopt a GAR Model, which we promptly did. However, while our participation loan portfolios were running off, our GAR Model showed we were never, even at peak, at serious risk (green and low amber). We therefore requested our participations be reinstated. And this is when we first heard of the new NCUA Risked Based Capital Policy – in early 2013.

According to this new policy, as interpreted by the field examination team, a credit union our size and complexity was seriously under-capitalized at 10% and would need to raise that to 13% before any participations loan program could be reinstituted. When asked to see the specifics of this "new policy" and finding it had yet to be proposed, we were informed that the examination team had the ability and responsibility to subjectively access our safety and soundness and implement prompt corrective action as a remedy as the examination team saw fit.

As it turns out, this language about subjective assessments at the regional and field level is part of the new (finally) proposed Risk Based Capital proposal. And while there has been much discussion about the risk model's asset risk weights, capital levels, and implementation schedule, this "subjective" license that is being given to the lower echelons of NCUA is chilling, dangerous, and demonstrably susceptible to hubris, especially for smaller asset-sized credit unions.

We had no less than six and upward to 10 examiners during our 2013 examination. A comparable examination team for Navy FCU – extremely larger and more complex that our credit union – would be no less than 6,000 to 10,000 examiners which is five to eight times the total number of NCUA examiners. And if the expertise and knowledge base concerning capital and risk at our examination – opinions aside – is reflective of scale moving up in size and complexity among all federally-insured credit unions, then one of several outcomes will surely prevail. At the lower levels of size and complexity and (presumably) expertise, the examiners' general lack of knowledge on RBC will be burdensome, disruptive and expensive. Eventually – if not now already – this will either force the smaller credit unions to merge or switch insurers. On the higher level of size, complexity and (presumably) capital and risk expertise, credit unions will have the upper-hand over examiners (unless, of course, 6,000 examiners do show). And if not given greater latitude within the proposed model, or simply interpreting it with greater skill and out maneuvering the examination teams – the probable outcome at the pre-Recession corporate examinations – these larger and more complex credit unions will either switch insurers or convert to a different charter under another federal insurer and the more favorable Basel III capital model. And in-between the high and the low, the credit unions in the middle will watch in horror as the distinct credit union model that has been developed and nurtured for almost a century is dismantled over naïve and untried notions of risk and capital.

The irony here, much like the irony our credit union experienced in 2013, is that the working and experienced risk based capital models credit unions have used for 80 years – while nothing like Basel III or NCUA I - not only survived the worst financial crisis since the Great Depression, but bailed out its insurance fund and manager in the process.

We have a saying among not-for-profits: “No good deed goes unpunished.” That seems to be very applicable here.

Like the many other respondents to this proposal, we strongly believe in more and better education in all matters financial, from our own households to the credit union, to the system as a whole, including capital and risk. But, even more strongly we believe that education – a core democratic value – is best achieved when done in cooperation and collaboration with one another. This is not only our credit union’s business model, it is our life’s model. And to have NCUA – our deposit insurance vendor – impose a non-collaborative, poorly understood and (already) abusively enforced rule offends our sense of democracy.

The Members of South Division Credit Union urge the responsible decision-makers at NCUA to suspend this proposal and develop a more equitable, professional and thoughtful risk based capital plan in collaboration with its constituent credit unions and industry stakeholders, submitting a new rule proposal sixteen months from now as the product of that industry collaboration, submitting to a new two-month comment period, and implementing the new rule on an eighteen month timeline from now.

Submitted on Behalf of the Members

Sincerely,

Mike Dillon
Director Member Services
South Division CU

cc: CCUL