



May 23, 2014

The Honorable Debbie Matz, Chairman
The Honorable Michael E. Fryzel, Board Member
The Honorable Rick Metzger, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: Proposed Changes to National Credit Union Administration's
Prompt Corrective Action Rules - Proposed Rule on Risk Based Capital

Dear Chairman Matz, Board Member Fryzel and Board Member Metzger:

American Share Insurance (ASI) appreciates the opportunity to submit our comments on the National Credit Union Administration's (NCUA) proposed rule on Risk Based Capital (RBC) that would revise the NCUA's current risk-based net worth standards under the agency's Prompt Corrective Action (PCA) rules. ASI, one of many stakeholders that will be impacted by the proposed RBC rule should it be enacted, provides excess deposit insurance to over 230 federally-insured credit unions in over 30 states, and primary deposit insurance of \$250,000 per account to over 130 state-chartered, non-federally-insured credit unions comprising approximately \$12.3 billion in insured shares. The proposal, if adopted, could affect the 230 federally-insured credit unions currently utilizing excess share insurance provided by ASI, or our wholly-owned subsidiary Excess Share Insurance Corporation (ESI), and we are presuming that the RBC rule would also eventually be adopted/accepted in the same or similar form by the state regulators in the nine states in which ASI provides primary deposit insurance.

As a deposit insurer, ASI supports the concept of capital levels tied closely to the riskiness of the assets backing the share liabilities of an insured credit union, and are well aware of the consequences when the risk and capital are not properly correlated. The concept of matching capital to risk is at the very core of deposit insurance. It is through capital sufficiency that we are best able to minimize the moral hazard created by the very presence of a deposit insurance system. Where we differ, however, is in that we do not support many of the risk weightings assigned to various asset classes under NCUA's proposed RBC rule that are more stringent than those that the banking industry has established. The more punitive risk weightings being proposed, effectively force credit unions to adopt far more conservative balance sheet strategies than those of their competition in banking. This approach is not supported by historical loss patterns when comparing FDIC bank losses to those sustained by NCUA as a result of Natural Person Credit Union (NPCU) failures. Further, the proposal "quantitatively" punishes credit unions that have high loan delinquency levels and a heavy concentration in long-term investments, non-commercial first mortgages and member business loans, all without sufficient consideration as to the adequacy of the credit union's "qualitative" measurements such as risk management and asset/liability management policies and procedures and loan underwriting standards.

Most of the differences in the risk weightings between credit unions and banks are readily apparent by comparing the NCUA's proposed RBC rule with the RBC requirements for banks. However, there are a few areas where the NCUA's higher RBC weightings are not as obvious, such as: (1) delinquent loans (the nominal weights are the same, but the effective weighting is greater for credit unions since credit unions report delinquencies at 60 days while banks report them at 90 days past due); and (2) deposits with the Federal Reserve Bank are zero weighted for banks; whereas, under the NCUA proposed rule they are weighted at 20%, as with regular bank deposits. More importantly, looking beyond these excessive weighting factors, the more-stringent proposed RBC requirements for credit unions could have devastating long-term effects, resulting in more credit unions seeking unnecessarily conservative asset and capital deployment strategies and even alternative capital sources – a solution currently only accessible under a bank charter. As a result, bank charter conversions may very well increase, which is an outcome that nobody in our industry wishes to see happen.

RBC, since its early beginnings in 1988 under BASEL I, and to its present day BASEL III underpinnings, was designed as a weighting system that established parameters for determining the requisite amount of capital needed for a given pool of assets based on their risk characteristics. RBC is a tool that provides guidance as to capital maintenance levels as part of an overall risk management program designed for asset deployment. Ideally, we believe that RBC should be holistic and used in combination with other risk management tools that already exist, such as asset-liability management models and the evaluation of net economic value of a credit union's equity as to the impact on equity from other risks such as changes in interest rates. Further, credit union risk management programs already include the evaluation of credit risk through policies and underwriting standards, and the RBC rule, as proposed with its arbitrary and generally more stringent risk weightings, could undermine the very reason such policies and standards exist. The NCUA has, and always has had, the ability to evaluate and critique policies and underwriting standards through the examination process.

The NCUA is not only proposing an RBC rule that is more restrictive than that of banks, they are further adding an additional layer of examiner subjective power under which an examiner can require higher than prescribed capital levels, with no limitations as to an RBC percentage required, in order to force a credit union into PCA even if the credit union otherwise meets the minimum "well capitalized" net worth ratio and the 10.5% RBC ratio. These proposed new powers within RBC, when applied to state-chartered credit unions, continue the erosion of state regulatory authority over respective state licensees through oppressive NCUA regulations. The NCUA's corrective action powers should be kept where they always have been – in the NCUA's ability to enter into documents of record, letters of understanding, consent orders and cease and desist orders. In addition, the NCUA already has regulations in place in which they can reduce a credit union's PCA classification by one category based on supervisory criteria other than net worth; i.e., issues involving safety and soundness. These existing powers should be sufficient without having to enhance them through the proposed RBC rule.

We also believe that the use of an asset size parameter of \$50 million for the determination of a "complex" credit union is an oversimplification. A credit union with more than \$50 million in total assets may be much less complex than one with less than \$50 million in total assets. The components of the balance sheet when considered with operational activities and management expertise should be the driving factors in determining what is truly "complex." It would seem that the US Congress, in passing/amending the Federal Credit Union Act (the Act), could have easily designated a total asset threshold for the application of RBC if that was their intent; instead the Act directs the NCUA to make a determination as to how to define "complex;" ironically, the NCUA's determination of "complex" turns out to be rather simplistic. There are a wide variety of possible parameters to determine "complex" that would be less arbitrary than a single asset size benchmark.

In conclusion, we believe that the NCUA's proposed RBC rule misses the mark as to what RBC should accomplish through a weighting system that establishes parameters for determining the appropriate level of capital needed to support the risk inherent in a given pool of assets. In summary, our key concerns over the proposed rule are:

1. The proposed RBC rule indirectly manipulates the composition of credit union balance sheets and, in a number of asset classes, the weightings are more punitive than those required of banks, in turn, limiting the services that credit unions can offer their members. Over time, this will adversely affect the competitiveness of the credit union system.
2. Even if a credit union currently satisfies the two-tiered capital tests ("well capitalized" net worth and RBC), the new rule would still adversely affect the credit union's future plans forcing most, if not all, credit unions to adjust their future asset deployment strategies solely to accommodate the RBC rules.
3. Despite the federal edict to match the actions taken by the NCUA's fellow federal regulators in establishing the RBC rule, the losses (number and impact on the insurance fund) sustained due to failed NPCUs pales in comparison to those of banks over the past five years, suggesting more favorable weightings for credit unions, not less favorable weightings.
4. In addition, while the proposed RBC rule somewhat parallels the capital rules for corporate credit unions, as implemented following the corporate credit union system collapse of 2009, the unprecedented magnitude of losses sustained by the NCUA, and the credit union system as a whole from the corporate failures, were a multiple of the aggregate losses in failed NPCUs for the same five-year period. More importantly, the asset class creating the losses in the corporate system – elaborate and complex residential mortgage-backed securities (RMBS) – presented a far lesser risk of loss in NPCUs.
5. Finally, the proposed RBC rule is a clear and direct attack on the authority of the state credit union regulatory system, by empowering the NCUA, through its examination staff, with arbitrary authority to effectively control the assets that a federally insured state-chartered credit union can invest in through the imposition of arbitrary and subjectively-determined RBC requirements in excess of 10.5% under the guise of "safety and soundness." While this impacts all federally insured credit unions, we further see this as another major setback for state regulatory autonomy.

Thank you for your consideration of our comments to the NCUA's proposed RBC rule. If you have any questions regarding this matter, please contact me at 614.764.1900, extension 101.

Sincerely,



DENNIS R. ADAMS
President/CEO

cc: Mr. Gerard Poliquin, Secretary of the Board, National Credit Union Administration