ideal credit union

May 21, 2014

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

VIA ELECTRONIC DELIVERY: regcomments@ncua.gov

RE: Prompt Corrective Action - Risk-Based Capital; RIN 3133-AD77

Dear Mr. Poliquin:

Thank you for the opportunity to comment on the proposed risk-based capital regulation. We believe the proposed rule has merit in theory, but has practical short comings in properly quantifying risks to capital. Also, we believe any risk-based capital rule must align with the Federal Credit Union Act per section 1790d. Lastly, we also believe that if there is ultimately a risk-based capital regulation, credit unions will need the ability to raise capital beyond earnings, which is currently the only source of capital accumulation.

The concept of risk-based capital on the surface makes sense. If risks can be clearly and consistently identified and then measured accurately against capital, risk-based capital would be warranted. The proposed rule states:

> "This proposed rule would provide a common measure of asset risk and ensure that credit unions retain levels of capital that are commensurate with their level of risk. The proposal would also help NCUA identify, and credit union to avoid, inadequately capitalized concentrations of asset classes that can lead to credit union's failure."

We believe your proposed rule will not do this. Your proposed rule intermingles measuring both credit and interest rate risk and is at times inconsistent when assigning risk ratings. Below are some examples:

1. You treat real estate loans differently than you treat GSE mortgage back securities. We are not certain why that is. An example would be carrying less than 25% of loans in fixed rate first mortgages. This particular asset receives a proposed risk weight of 50%. If these same real estate loans are securitized and then purchased back as a GSE mortgage back security, the risk weight of the mortgage back security would most likely increase to 150%, requiring

significantly more capital for this asset. Under this scenario, the asset's risk was greatly reduced as credit risk is eliminated and the asset becomes more liquid.

2. You treat US Treasuries and NCUA Guaranteed notes as having no risk. We are uncertain how this 0% risk weighting was determined. At a minimum these types of investments have interest rate risk.

3. You treat the liability side of the balance sheet as having no offset against risk. Again we are uncertain as to why you would not take into consideration the liability structure of a balance when assessing risk. Liability management plays a significant role in the credit union's interest rate risk and liquidity risk positions. Not giving credit for this side of the balance sheet completely ignores half of the equation in managing interest rate risk. Ignoring this could potentially underestimate risk for some credit unions while overestimating risks for others.

4. You treat all non-delinquent loans at the same level of risk. We once again are unsure how this could possibly measure credit risk properly. No matter the collateral position or credit score, all loans are given the same risk rating of 75%. We do not understand how a loan that has a 740 credit score secured by a new auto, with a LTV of 80%, can be given the same risk based capital requirements as a loan with a 650 credit score that is unsecured.

5. You treat all mortgage loans with the same level of risk no matter the LTV, credit score, or final maturity. Again, we believe this doesn't properly measure credit risk. During the great recession of 2008-2010, credit unions with high LTVs took the largest losses to capital.

As you can see, these 5 examples clearly show that the objective established by the board could not be possibly met. Also, the risk weightings seem somewhat arbitrary. The proposed regulation is very vague as to the justification and assignment of the risk weightings for the various asset classes.

It also appears that the proposed risk based capital proposal goes beyond the Federal Credit Union Act. In section 1790d (d) (2) the act states; "The Board shall design the risk-based net worth requirement to 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". The proposed risk-based capital proposal adds additional requirements for credit unions that are considered "well capitalized". The act clearly only references risk-based net worth requirements for "adequately capitalized" credit unions. Based on the proposal, the maximum risk-based capital requirement should only be 8%. The requirement of 10.5% to be considered well capitalized goes beyond the section of the act.

Lastly, if risk based capital becomes a regulatory requirement, it is imperative that credit unions have access secondary capital. Not allowing accesses to secondary capital could cause credit unions to be severely restricted in growing its franchise. This is especially true for well-run credit unions because of a change in the rules need some additional cushion in order to stay in compliance with the risk-based capital rules. Credit unions are already at a disadvantage in the financial market because they do not have the ability to access additional capital outside retained earnings.

In closing, we believe the current rules and regulations in place governing capital and balance sheet risks are appropriate and sufficient to manage the credit union's balance sheet. **The current risk based capital proposal is not workable and should be taken off the table for consideration.** The current leverage capital ratio requirement of 6%-7% capital is sufficient and higher than set for banks. This coupled with proper risk management of the balance sheet should be sufficient to address balance sheet risks. Natural person credit unions weathered the great recession quite nicely under the current capital rules and had little impact to the NCUSIF. We believe this fact alone speaks for itself concerning proper capital limits. Adding another layer of seemingly arbitrary and inconsistent risk weightings, based on only one side of the balance sheet, is non-productive and could have unintended consequences of adding more risk to the balance sheet and handcuffing well managed credit unions. **Also, requiring additional capital levels for credit unions considered well capitalized goes beyond the requirement established in the Federal Credit Union Act.**

If you have any questions about our comments, please feel free to contact me at 651-747-8902.

Sincerely,

Dennis R. Bauer
Executive Vice President and CFO