From:	Eric Rauch
To:	_Regulatory Comments
Subject:	Prompt Corrective Action Risk-Based Capital Comment Letter
Date:	Friday, May 23, 2014 1:00:55 PM

Dear Secretary of the Board Poliquin,

Investments as currently weighted will cause specific problems for some credit unions when the next financial crisis arises. As currently constructed the weights seem to assume that long term investments cause more risk than short term investments. While this may be true from an interest rate risk perspective in a rising rate environment, it has not been over the past decade of global recession and extremely low rates. Had a credit union with a 7 to 7.5% net worth ratio in 2006 needed to go longer on the yield curve to increase earnings to bolster their retained earnings to avoid PCA because the flight to safety had begun causing and balance sheets to grow, they would have potentially been unable to do so because of the proposed rule would have penalized them on the their Risk Based Capital (RBC) requirements.

As economic conditions improve, as they have been over the past few years loan growth increases and the proposed loan weighting s will dramatically affect the types of credit that a credit union can offer it membership. The RBC proposal considers loans secured by real estate through a second mortgage to have just as much risk as credit card loans. Clearly this is not the case, especially given the post-recession restrictions on mortgage lending as a whole. Second mortgages should not be weighted any higher than 0.50 unless they are non-performing. There needs to be some recognition that the post-recession mortgage lending environment is dramatically more conservative than what existed prior to 2010 and that that type of home value bubble is unlikely to reoccur under the new rules.

The RBC rules would effectively marginalize CUs ability to provide quality first mortgage loans to their members, one of the most fundamental types of loans that the Federal Credit Union Act implies that CUs should be providing when it states “to provide credit for prudent and provident purposes”. This restriction is caused by the confluence of several elements; first, in order to be able to create a quality mortgage loan program in today’s highly regulated world, scale is vital. In order to ensure that both high quality mortgage lending staff and top notch software and compliance resources are available, a CU must invest heavily in this area and that can only be done through scale. The RBC would restrict the ability of many credit unions from serving their members because of the escalation of the risk weighting based on this concentration. It is true that too many long term fixed rate mortgages could be damaging in certain rate environments. However this rule assumes that CU executives and NCUA are not capable of managing interest rate risk through other tools and regulations. The other very troubling area is the weighting for Servicing Rights, this weighting would discourage CUs from selling pools of mortgages and retaining the servicing because of the onerous 2.50 weight for this item. Clearly, this is in direct opposition to the intent of the aforementioned rule regarding concentration risk of mortgage loans, effectively making it “dammed if you do and dammed if you don’t” to hold mortgages. The only remaining options to avoid the RBC penalties is to either not make mortgage loans to your members or sell all loans servicing released and leave your members at the mercy of an unknown entity to collect their payments and mange any problems that arise. Additionally the RBC rule would potentially cause CUs that retain servicing to take great risks by booking servicing assets at higher values at the date of sale because of the need for immediate income to bolster net worth. Let me explain, GAAP requires CUs to book an asset at the time of sale for the servicing rights. There is no specific right answer for this but rather a range of estimated values. So the higher the value that is booked the greater the serving income at the date of sale, but this also increase the possibility of impairment during the life of the asset. So many CUs, like INOVA, choose to take less income at the time of sale and book the asset a lower and more conservative value. This means that we have reduced the probability of future impairment and that we will collect stronger cash flows in the future. But the new RBC weighting of 2.50% would force us to harvest as much income up front to build our reserves immediately, a risk we would not otherwise take.

The CUSO weighting also seems to be a one size fits all solution. A good example is the fact that we hold some of our real estate and branches in CUSOs in the event that litigation would occur around one of these assets. In this case only the CUSOs assets would be exposed to potential litigation. Under the new rule we would have to move these assets directly onto our books and increase our potential liability needlessly. We also have a CUSO that acts as a pass through for providing tellers for a joint branch shared with another CU, clearly this is no more risky than running one of own teller lines, however the RBC makes no distinctions. We do operate a CUSO that is a separate business line and may need to be weighted differently, but more thought must be given to how each CUSO should be assessed.

Our investment in the CLF falls into the All Other Assets category and is given a weight of 1.00, this should be 0%. Why would our CLF investments have to be weighted the same as delinquent real estate loans?

Our deposits with the Federal Reserve Bank are given a .20 risk rating because they fall in the investments of 0-1 years bucket. It seems to us that if the Federal Reserve fails we have much bigger issues than the RBC rule.

The penalty for almost all government backed agency investments is so severe at 2.00 that CUs would be discouraged from effectively creating an ALM policy that addresses many interest rate environments.

Sincerely,

Dallas Bergl
358 S Elkhart Ave
Elkhart, IN 46516