CAROLINAS
CREDIT UNION LEAGUE

North Carolina
323 West Jones Street, Suite 200
Raleigh, North Carolina 27603

South Carolina
7440 Broad River Road
Irmo, South Carolina 29063

May 21, 2014

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

Re: Comments on Proposed Risk-Based Capital Rule

Dr. Mr. Poliquin

The Carolinas Credit Union League (CCUL), a trade association representing the interests of 160 credit unions in North and South Carolina, appreciates the opportunity to comment on NCUA's proposed rule, "Prompt Corrective Action--Risk-Based Capital (RBC)." CCUL understands that credit unions are more than financial institutions; they are community institutions built on a philosophy of people helping people. With that in mind CCUL works to protect and advocate for credit unions that provide financial services to their member owners.

The Federal Credit Union Act directs NCUA to develop a risk based capital rule that is comparable to the other financial regulators while reflective of the uniqueness of credit unions. We support any effort by NCUA to develop a more comprehensive risk-based capital framework under these required statutory guidelines.

The current proposal fails to meet both elements outlined in the statute. The proposal is neither comparable to that of other financial regulators nor does it recognize the uniqueness of credit unions. The extreme risk weights assigned in the proposed rule will put credit unions at a distinct competitive disadvantage with banks and impede delivery of service to credit union members. Credit unions will be forced to ration services that members need and want in an effort to meet the risk-based capital requirements that in no way reflect the risk associated with the activity. In this scenario, meeting the needs of members - a unique and defining characteristic of credit unions - takes a backseat to a regulatory mandate.

We do not think we are overstating our concern in suggesting that the current proposal will drastically erode the value of the credit union charter and give many credit unions cause for considering converting to a bank. Credit unions need a balanced rule that provides them tools to compete with other financial institutions and the flexibility to meet the needs of their members.

In what follows we have outlined our concerns and suggested some changes to the proposed rule in an effort to provide NCUA with guidance on how we can achieve a balanced rule.

RISK WEIGHTS

One of the most controversial aspects of the proposed rule is the assignment of risk weights to various elements of the risk based capital ratio. The risk weights appear to be NCUA's subjective opinion based on those credit unions that failed or faltered during the last economic crisis instead of a balance of what went wrong with what credit unions did right. As written, the proposed weights are not accompanied by any rationale and appear to penalize credit unions that offer products such as member business loans and first mortgage loans. For credit unions to better understand and comment on risk weighting, the NCUA should provide the industry their underlying analysis including historical data and how risk weight categories were assigned. Transparency is key to a successful risk-based capital system. Outlined below are our detailed concerns.

<u>Current and Non-delinquent First Mortgages</u>
NCUA's proposed rule assigns three different risk weights for current and non-delinquent first mortgage loans. The proposed risk weight is dependent on the concentration level of these types of mortgages. In our view, the proposed risk weights fail to recognize several existing ways credit unions are effectively managing mortgage lending risk. First, credit unions have implemented policies, procedures, and regular monitoring by boards and senior management to assess and make adjustments to their portfolios to address concentration and interest rate risk. Second, many credit unions are very deliberate about types of first mortgages they make, managing risk by balancing their portfolios with a mix of variable rate and fixed-rate loans. The proposed rule does not consider the type of first mortgage loan. Finally, the recently implemented CFPB mortgage lending rules, which have resulted in more stringent underwriting requirements, provide an additional check on the risk associated with mortgage lending.

Beyond the items outlined above, we are perhaps most perplexed by these proposed risk weights because they seem to suggest, absent any NCUA rationale, that a mortgage loan at a credit union is riskier than a mortgage loan at a bank.

CCUL recommends that NCUA either implement the Basel III risk weight of fifty percent (50%) or take into consideration the makeup of the first-mortgage portfolio.

<u>Member Business Loans (MBL)</u>
The proposed rule assigns three different risk weights for MBLs based on the concentration level of the MBLs to total assets. Under the proposal, risk weight is dependent solely on the concentration level of the credit union's MBL portfolio and does not take into consideration the risk mitigating factors built into NCUA's regulation of MBLs, such as the cap on the amount of MBLs, the extensive and detailed policies and procedures as well as education requirements of business lending officers. Combining the proposed risk weights with the limitations already imposed on credit union business lending creates a significant disincentive for credit unions to continue to the practice. CCUL recommends that NCUA provide a single risk weight of 100%. If not, CCUL recommends alternatively that NCUA consider not only the concentration level of the portfolio but also the diversity and complexity of the MBL portfolio. A credit union provides its members a valuable service at a reasonable cost when offering member business loans and the members would suffer if MBLs are not available.

<u>Investments</u>
In general CCUL disagrees with the proposed risk weighting of investments since they are only categorized based on years to maturity. The risk in an investment is in its underlying collateral, not solely its term. The proposed rule appears to account only for the term while ignoring the credit

risk of the investment. A credit union with an investment portfolio with variable maturity terms knows it must balance those terms against liquidity needs as well as adequate yields to support the income statement.

NCUA should also consider that fields of membership for some credit unions consist of single sponsor or select employer groups with an older and a more conservative work force that has more need for deposit products than loan products. A credit union of this type must find an income source to offset low loan need, and without access to supplemental capital, the investment portfolio plays a significant role in balance sheet management. Credit unions in this position have strategically purchased investments, and monthly investment portfolio analysis helps credit unions manage their investment risk. The board of directors and senior management tend to be more conservative, investing in federal agency securities which are very marketable to help control interest rate risk. CCUL recommends that NCUA follow Basel III's risk weighting for investments.

<u>Credit Union Service Organizations (CUSO)</u>
CUSOs are part of the cooperative spirit of the credit union industry. Credit unions invest in CUSOs to improve operational efficiencies, increase revenue, or provide products and services to credit unions that they cannot offer the services due to costs. When a credit union invests in a CUSO, the risk taken by the credit union is the loss of its investment. NCUA again has provided mitigating risk factors for investing in a CUSO, with recent changes to the CUSO rule along with due diligence performed by the credit union. For these reasons CCUL recommends NCUA apply a risk weight of 100% to CUSOs as the 200% risk weight is excessive.

EXAMINER DISCRETION TO REQUIRE HIGHER CAPITAL REQUIREMENTS

CCUL strongly disagrees with NCUA's additional authority to impose higher capital requirements on individual credit unions. There are several inherent problems with this section of the proposed rule:

- The rule is based on an examiner's subjective judgment, which can differ from one credit union to another and from one examiner to another.
- NCUA does not set a ceiling for a higher capital requirement, creating an unacceptable level of uncertainty for a credit union attempting to plan strategically for the future.
- There is no check and balance on the agency's regulatory power.

NCUA has other regulatory powers to address a higher risk-based capital ratio, such as the new CUSO rule, capital restoration plans, and availability of penalties. The proposed rule does provide an appeal process for a credit union placed in this situation by an examiner. CCUL recognizes that NCUA's OIG can review NCUA's decision. However, we feel the OIG is not far enough removed from this appeal process. CCUL urges the NCUA to delete this section. If the agency does not delete the section, CCUL recommends the NCUA provide more objective criteria and an independent third party to review an examiner's requirement that a credit union increase its risk-based capital.

NCUSIF TREATMENT

The NCUSIF one-percent (1%) deposit is ignored under the proposed RBC calculation. Deletion of the NCUSIF from the RBC calculation is inappropriate since it is an asset available in liquidation of a credit union. FASB and GAAP also give value to the NCUSIF, and NCUA has the ability to address any issues with the NCUSIF through assessments to credit unions.

IMPLEMENTATION DATE

NCUA's eighteen-month implementation does not provide credit unions sufficient time to plan for the changes. Many credit unions have strategically built capital buffers over numerous years of planning and with very limited means to raise capital under present statutes and regulation. Credit union boards of directors and senior management will need more than eighteen months to review their strategic plans and alter their balance sheet composition in response to the final rule. We recommend NCUA consider a mutli-year implementation period especially in light of the time banks were given to comply under Basel III.

DEFINITION OF A COMPLEX CREDIT UNION

CCUL agrees that credit unions under $50 million should be exempt from the rule as they do not pose a significant risk to the NCUSIF. However, the proposed asset threshold of $50 million on a complex credit union is both simplistic and overly broad. A complex credit union is defined by more than its asset size, and NCUA should consider whether the credit union's operations are diverse enough to warrant the "complex" designation.

SUMMARY

Capital adequacy is a dynamic process that requires a credit union to monitor performance and adjust goals toward future capital goals and its opportunities to best serve its members. Although CCUL opposes the rule as proposed, we agree the risk-based capital requirement could provide valuable guidance provided the rule is balanced, fair, and sufficiently flexible for credit unions to manage their balance sheet. To maintain a strong successful credit union industry, the NCUA must provide credit unions the ability to evolve and grow. CCUL requests the NCUA consider creating a working group of credit unions to support comment review and finalization of the rule.

Thank you for the opportunity to comment on this proposed rule and for considering our views on the risk-based capital requirements.

Sincerely,

Jeanne Couchois
VP Regulatory & Compliance Counsel
Carolinas Credit Union League