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May 23, 2014

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

Re: Prompt Corrective Action – Risk-Based Capital Proposed Rule

Dear Mr. Poliquin:

ESL Federal Credit Union ("ESL") located in Rochester, NY and serving approximately 319,000 members, appreciates this opportunity to comment on the National Credit Union Administration Board's (the "Board") Proposed Rule on Prompt Corrective Action – Risk-Based Capital (the "Proposed Rule").

In issuing the Proposed Rule, the Board's intent is to enhance risk sensitivity; address perceived weaknesses in the existing regulatory capital framework for credit unions; establish a risk-weighting system that is more indicative of the potential risks existing within credit unions; help credit unions better absorb losses; and establish a safer, more resilient, and more stable credit union system. To further the Board's intent, the Board sets forth five goals for the Proposed Rule. The Rule should: address weaknesses in the net worth ratio measure; address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk; enhance the stability of the credit union system; rely primarily on data already collected on the Call Report to minimize additional recordkeeping burdens; and be as easy as possible to understand and implement. The proposed risk-based capital requirements are intended to be more consistent with the measures used by the Other Federal Banking Regulatory Agencies ("Banking Agencies").

We agree with the Board's intent but believe both the goals and the Proposed Rule itself run counter to the Board's objectives.

First, the Proposed Rule significantly deviates from and is generally inconsistent with the Banking Agencies. The equivalent risk-based capital framework for the Banking Agencies assigns risk-weights based on the inherent risk of loss that exists within different asset classes; it does not include risks for operational components.

For non-investment assets, non-delinquent consumer loans have a better risk weighting than the Banking Agencies, while FHA/VA guaranteed residential mortgages, non-delinquent first mortgage loans greater than 25% of assets, other real estate loans greater than 10% of assets, and MBLs greater than 15% of assets all have worse risk weightings than the Banking Agencies. For investment assets, most assets with a weighted average life longer than one year have higher risk weightings than the Banking Agencies.

Second, the Proposed Rule attempts to quantify risk exposure not only through credit risk but through concentration risk and interest rate risk as well. By assigning risk-weights based on concentration and average life, the Proposed Rule may drive credit unions to invest in higher-risk assets or take on potentially unsuitable risk.

An example of investing in higher-risk assets is consumer real estate secured lending. A portfolio mortgage is assigned a risk-weight of 50%; if that loan becomes delinquent, it is assigned a risk-weight of 100%. Compare the portfolio mortgage with a GSE security which is assigned a risk weight of at least 150% if the weighted average life is greater than five years. The Proposed Rule implies that the GSE security investment—a liquid, moderate-term investment with a government guarantee—poses a much higher risk than a long-term, non-guaranteed mortgage. Moreover, the Banking Agencies assign a 20% risk weight to the GSE security.

An example of taking on unsuitable risk is the non-investment risk category. In the Proposed Rule, other real estate loans are assigned risk weights of 100% to 150% and are separate from first mortgage loans. Member Business Loans ("MBL") are assigned risk weights of 100% to 200% despite a credit union (absent a waiver or being chartered as one that can make MBLs) being regulatorily limited to making MBLs to 12.5% of total assets. Compare other real estate loans and MBLs to consumer loans. Consumer loans as a whole are assigned a risk weight of 75%, concentration level notwithstanding. Therefore, the implication is that an unsecured non-delinquent consumer loan has a lower risk weight than a secured other real estate loan or a secured MBL.

Third, the Proposed Rule reduces the level of loan loss reserves that can be included as capital. Under the existing rule, the Allowance for Loan and Lease Losses ("ALLL") is limited to 1.5% of total risk-weighted assets. Under the Proposed Rule, the ALLL is limited to 1.25% of total risk-weighted assets. The Proposed Rule states that lowering the percentage provides an incentive for granting quality loans and recording losses in a timely manner. However, reducing allowable reserve levels could lead to double counting of loss coverage during periods of financial stress.

Fourth, regarding investment assets and weighted average life, except for investments that have full government guarantees, the Proposed Rule assigns risk weights based on the length of the investment and does not give proper consideration to the type of investment. Because of this, we are incentivized to invest in short-term, lower-yielding investments rather than reasonable, longer-term investments in order to avoid the higher risk weighting. The former investments—condoned by the Proposed Rule—impair our ability to supplement capital and earnings while allowing unlimited interest rate risk. The latter investments—punished under the Proposed Rule—allow for higher earning, greater capital accretion, and more stable management of overall interest rate risk. We use our ALM Policy to earn the best interest rate for both short- and long-term investments while managing interest rate risk. In a stable or falling interest rate environment, having short-term assets funded by long-term liabilities reduces spread income. Pushing us into lower yielding short-term investments may cause us to shorten our liabilities in an effort to improve income. Compare the Proposed Rule with the Banking Agencies, where risk weightings are based on investment class rather than weighted average life.

Fifth, we do not agree with the Proposed Rule's 250% risk weight assigned to CUSO investments or to the discrepancy with the 100% risk weight assigned to CUSO loans. The Proposed Rule does not explain the difference in the risk weights which suggests that loans to CUSOs are 2 ½ times safer than investments in CUSOs. The rationale for this high investment risk weight is that a CUSO is an unsecured equity investment with no secondary market.

We recommend that investments in CUSOs should be assigned a risk-weight of 100 percent to align it with loans to a CUSO and more accurately reflect the risk involved with investing in a CUSO. This, coupled with the examination and supervision process outlined in the recent CUSO Final Rule, should properly manage any exceptions to credit union risk related to CUSOs.

Sixth, we do not agree with the Proposed Rule's 1,250% risk weight assigned to asset-backed investments for which we are unable to demonstrate a comprehensive understanding of the features of the asset-backed investment that would materially affect its performance. The Proposed Rule does not provide sufficient clarity or explanation on when the NCUA can make the determination that we do not have a comprehensive understanding of an investment. In the absence of clearly defined criteria, this requirement will lead to inconsistent findings.

Seventh, we do not agree with the Proposed Rule's Individual Minimum Capital Requirement that allows the NCUA to require a higher minimum risk-based capital ratio for an individual credit union in any case where the circumstances indicate that a higher minimum risk-based capital requirement is appropriate. On its face, this section appears to replace the standardized capital framework with a subjective, potentially inconsistent, determination that an otherwise well-capitalized credit union needs additional capital based on its perceived exposure to risk. Because it is not clear how these risks are measured, we would have to prepare for a subjective finding by sacrificing appropriate risk-taking. Therefore, we believe the Proposed Rule's Individual Minimum Capital Requirement should either be rewritten to incorporate objective measure or removed.

Finally, we believe that the 18 month implementation period is too short. We need at least three years to research, develop and plan the fundamental changes to our loan structure, investment portfolio and planned future product offerings.

In conclusion, we agree with the Board's intent to establish a risk-weighting system that is more indicative of the potential risks existing within credit unions. We do not believe the Proposed Rule satisfies the Board's intent. By attempting to control numerous types of risks—concentration, credit, interest rate—through a single capital ratio, the Proposed Rule is inconsistent and rewards risky behavior.

We are a well-capitalized credit union both under the current rule and, based on our calculations, under the Proposed Rule. Our concern is that in the future as we continue to grow our portfolio and make appropriate investments, the Proposed Rule's incongruous risk weightings and Individual Minimum Capital Requirement will put us at a competitive disadvantage to the Banking Agencies.

ESL appreciates this opportunity to comment on the Proposed Rule. If you have any questions or would like to discuss this Comment Letter, please contact me or Jim Darcy, Treasurer, at jdarcy@esl.org or 585.336.1054.

Very truly yours,

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