TMG FINANCIAL SERVICES℠

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

May 22, 2014

Dear Mr. Poliquin:

I appreciate the opportunity to comment on the National Credit Union Administration's (NCUA) proposal regarding risk-based capital requirements. I represent TMG Financial Services (TMGFS) located in Des Moines, Iowa. TMGFS is a CUSO partner for nearly 40 credit unions across the United States. TMGFS provides our partners with the ability to offer a low cost, nationally competitive credit card offering to their members while earning a steady stream of non-interest income for the credit union. In some cases, TMGFS has been instrumental in delivering products and services that were previously out of reach for some of our partner credit unions and necessary to compete against other financial institutions in their markets.

TMGFS supports and appreciates NCUA's commitment to ensuring the safety and soundness of the credit union industry. However, TMGFS does have several concerns regarding the Risk-Based Capital proposed rule. Specifically, TMGFS is concerned with the impact of the risk-based capital ratio calculation, the relationships between the proposed asset risk weightings as well as several of the proposed risk weights for individual asset classes, the provisions for examiner discretion within the proposed rule and the timing for the implementation of the rule. TMGFS has identified several negative implications regarding the above and has concerns for CUSOs, credit unions and credit union members.

As an agent issuer for our credit union partners, TMGFS has a responsibility to identify, manage and mitigate different market and lending risks to ensure the success and stability of the CUSO. TMGFS maintains sufficient capital levels to withstand significant stresses that could arise due to different market or industry specific events. The risk weight proposed for CUSO investments will make it more difficult for TMGFS to raise capital in the future. A reduction in the supply of capital will limit the CUSOs ability to grow. TMGFS provides a very specialized set of capabilities in credit card lending that add significant value to our partner credit unions. Restricting the ability of TMGFS to grow through a reduction in the capital available restricts the ability of the CUSO to serve credit unions and their members. As credit card lending becomes increasingly more sophisticated credit unions will be in greater need of our services to be able to provide competitive lending products to their members.

TMGFS requests that NCUA review and consider the following points.

Risk-Based Capital Ratio

The proposed rule limits the amount of Allowance for Loan and Lease Losses (ALLL) that may be included in the risk-based capital ratio to 1.25% of risk assets. GAAP requires a credit union to maintain adequate reserves for losses based on documented forecasts of asset growth and future losses. This balance sheet line is heavily scrutinized by auditors when performing a financial audit for a credit union to safeguard against an under or over-funded allowance. It seems reasonable that the full amount of ALLL should be available to be used in the risk-based capital ratio calculation considering the entire amount could be used to mitigate any losses in the represented assets. The accuracy of the credit union's determination of needed reserves is supported by credit union documents and the completion of a successful audit. Including 100% of the ALLL would still encourage safe underwriting practices and support recognizing losses in a timely manner as reducing losses is critical to maintaining healthy income levels.

Similarly, a credit union's deposit to the National Credit Union Share Insurance Fund (NCUSIF) should not be excluded from the risk-based capital ratio. This deposit is reported as an asset for GAAP purposes and shows the credit union has federal deposit insurance – an important asset to credit union members providing not only insurance but also piece of mind. The NCUSIF deposit is meant to guard against losses in the credit union system as a whole and therefore it seems unreasonable to exclude the deposit when examining the capital adequacy of the credit union making the deposit.

When examining the assets included in the denominator of the equation there seems to be no mention of the liability side of a credit union's balance sheet. It is hard to assess the risk of an asset without also exploring the measures a credit union has implemented to absorb that risk. The analysis proposed in this rule appears to ignore prudent steps management may be taking to eliminate the risks associated with longer duration assets, liquidity, operational and market risks. If a credit union has extended its duration on the liability side of the balance sheet, longer asset durations might make sense and in some cases even mitigate risk versus increasing risk.

Individual Risk Weightings

One way to reduce risk of any kind is through effective diversification efforts. To reduce any single credit union's exposure to any one CUSO would be to diversify the ownership of the CUSO and spread a credit union's available investment dollars across multiple CUSOs. The targeted risk weighting of 250% for CUSO investments would seem to do the opposite and discourage credit union investment in CUSOs altogether when any risk present in the investment is easily mitigated through diversification. NCUA should be encouraging CUSO investments as a way to increase credit union competiveness and to reduce risk within the credit union industry.

Furthermore, NCUA already has aggressive restrictions on cumulative investments allowed in CUSOs. Federal credit unions currently have the authority to invest no more than 1% of their paid-in and unimpaired capital and surplus in CUSOs structured as a corporation, limited liability company, or limited partnership. Given this is a cumulative restriction; it would be difficult for a credit union to amass a sizeable equity investment in any one or in several CUSO investments. This investment limitation combined with the risk weighting of 250% is overly restrictive and may prevent credit unions from exploring CUSO investment options. As you are aware CUSO's provide valuable products and services to credit unions and to credit union members. Some credit unions rely heavily on the income derived from their CUSO investments and depend on CUSO products and services to deliver a full suite of completive products and services to their members. In many cases CUSOs have specialized expertise and economies of scale that allow for providing greater value to credit union members than credit unions could provide on their own.

NCUA takes a one size fits all approach to the risk weightings. For example, a credit union with an investment in a CUSO engaged in lower risk ventures would require the same capital contribution as an equal investment in a CUSO engaged in a more progressive venture. Similarly a credit union making an investment in a CUSO that maintains a 15% capital ratio would be treated the same if investing in a CUSO maintaining a 5% capital ratio. The asset type is only one factor when considering investment risk to a credit union and should not be treated as if all investments in similar assets are identical.

The weights between categories of assets should be reconsidered to ensure consistency between the risk of the asset and the risk weighting. For example, a current, unsecured credit card loan is risk-weighted at 75% however a loan to a CUSO that owns a credit union's credit card portfolio and provides outsourced credit card management on behalf of that same credit union, is risk-weighted at 100%. If the CUSO absorbs all losses and simply provides an income stream from the loan back to the credit union, funding the same asset class to a CUSO does not add more risk to a credit union than funding the actual asset class within the credit union. Similarly, new vehicle loans are also risk-weighted at 75% despite the typical underlying collateral value included in this type of lending versus the typically unsecured lending inherent in a credit card loan. The relationships between loan categories requires additional consideration to ensure that risk-weightings are consistent with the risk a credit union is accepting when making different loan types.

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Examiner Discretion

The proposed rule allows for NCUA examiners to use their discretion to increase capital requirements for an individual credit union based on discoveries made during the exam process. However, the reasons cited in the proposal for including this provision are already controlled through other regulatory means. The proposed rule calls for the removal of provisions for “risk credits” based on the reasoning that “in practice, it is very difficult to determine the validity of the credit union’s mitigation efforts and how much mitigation credit to allow”. If it is difficult for an examiner to determine how well a credit union has mitigated its risk then it would also be difficult for the same examiner to determine whether additional capital is required for that credit union on a case-by- case basis.

The section goes on to explain when additional capital may be warranted based on exam findings. One of these reasons would include the expectation for future losses that would diminish the capital adequacy of the credit union. This is already accounted for through the ALLL provision and the resulting “credit” in the risk-based capital ratio calculation. Allowing this discretion not only duplicates the regulatory restrictions already in existence but increases the risk that credit unions will be treated differently based on their examiners individual perspective.

Another reason cited to increase capital requirements is a high degree of exposure to interest rate risk, credit risk and concentration risk all of which are already included in the risk-based capital ratio calculation through assigning of different risk rates for asset classes and asset concentration considerations.

Finally, strong credit union growth and enhanced capital needs arising from that growth is listed as a reason to increase capital requirements. Although a credit union may be growing rapidly, given the other requirements of the proposed rule, that credit union would also have a plan in place to maintain adequate capital levels throughout and after the growth period. Placing additional capital requirements on a credit union in a high growth phase is counter-productive and creates a dis-incentive for credit unions to capture additional market share and serve more consumers.

Examiner discretion should be removed to allow credit unions to adequately anticipate their capital needs and ensure consistent and objective treatment for all credit unions.

Implementation

Considering the limited ways a credit is able to raise capital it is unlikely that a credit union failing to meet these requirements would be able to achieve the needed capital within the 18 month implementation window without significant efforts that could negatively impact members. Credit unions may be placed in a position of cutting expense, reducing dividends or increasing loan rates resulting in loan and deposit products that are not competitive in their markets. In addition, if a credit union was unable to make these changes fast enough, a capital restoration plan for the credit union would be required by NCUA. This would take devotion of time and resources at the credit union as well as within NCUA to monitor. This is a resource restriction that could be easily alleviated by re-considering and extending the time frame for implementation of the proposed rule. Given the magnitude of change proposed in the rule more time is needed for exploration of the implications of the proposed rule as well as the implementation of the rule.

Closing

TMG Financial Services encourages NCUA to take this response and other responses into account and to consider a revision of the proposed rule that would more accurately account for risk and phase in changes to capital adequacy requirements over a longer period of time.

Sincerely,

Jon Sarvis
Chief Executive Officer
TMG Financial Services