May 23, 2014

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

Re: Self-Help Comments on Proposed Rule: PCA — Risk-Based Capital

Via e-mail: regcomments@ncua.gov

Dear Mr. Poliquin,

Thank you for the opportunity to comment on the National Credit Union Administration's Proposed Rule on Risk-Based Capital. We are providing this comment on behalf of both Self-Help Credit Union, a federally-insured, North Carolina-chartered credit union with 60,000 members and $670 million in total assets, as well as Self-Help Federal Credit Union, which serves 50,000 members in California and Illinois, and has $560 million in total assets (collectively, "Self-Help").

**Summary**

Self-Help agrees with NCUA's recognition that the existing risk-based net worth standard does not accurately reflect the credit risk associated with credit union balance sheets and needs to be updated to be better aligned with the Basel III standards applied to banks and thrifts. We agree with the proposed 8.0% and 10.5% standards, which will reduce risk to the National Credit Union Share Insurance Fund ("NCUSIF"). Self-Help applauds NCUA for recognizing that secondary capital should be included as capital for the thousands of low-income designated credit unions that have statutory authority to include secondary capital as net worth.

At the same time, Self-Help strongly disagrees with NCUA's proposed risk-weights for the various asset classes covered by the proposed regulation. We believe that NCUA should – and in fact, must – adopt the Basel III risk weights that have been applied by the joint banking agencies in the United States. In particular, the proposed risk weights for mortgage and member business lending "concentration" penalizes credit unions for making the exact same loans that are made by banks for no other reason than operating under a different charter.

301 West Main Street, Durham, NC 27701
P.O. Box 3619, Durham, NC 27702-3619

Tel: 919.956.4400 / Fax: 919.956.4600
www.self-help.org

In addition, we have two other recommendations that we believe will significantly enhance the proposed risk-based capital ("RBC") standard:

- Remove the proposed deduction of a federally-insured credit union's NCUSIF deposit from the numerator and denominator in the proposed regulation. The NCUSIF deposit is a tangible asset to NCUA, as the liquidating agent of a credit union.

- Raise the asset level for credit unions subject to the risk-based capital standard to either $250 or $500 million. In our experience, very few credit unions under $500 million in assets have truly complex balance sheets and do not create substantial risk to the NCUSIF itself.

**RBC risk weights should not be greater than Basel III and must not penalize credit unions in comparison to their peers and competitors in mortgage and business lending**.
Self-Help agrees that a modernized risk-based standard more accurately reflects the risk associated with federally-insured credit unions' balance sheets. As credit unions painfully learned after the collapse of the corporate credit union system, the NCUSIF is a collective obligation of the movement and its members. Modernizing the risk weights for assets to the currently accepted international standard – Basel III – better reflects risk and thereby protects the NCUSIF, credit unions and their members. For credit unions that have unmitigated concentration in a specific sector, NCUA should use its supervisory authority to require risk mitigation, rather than applying a higher capital requirement that ignores any such mitigation the credit union undertakes.

While NCUA's proposed RBC risk weights are based on the relatively simple, clear Basel III standard, the agency's attempt to layer in "any material risks" under the FCU Act falls short of a clear, risk-weighted standard. Most significantly, NCUA increases the risk weighting of mortgages and member business loans ("MBLs") as a credit union becomes more concentrated in its deployment into such loans, which is inconsistent with Basel III as applied to U.S. banks and thrifts.

**The proposed higher risk weights as a credit union increases its investment in mortgages and/or MBLs would place credit unions at a significant market disadvantage for making the exact same loan that a bank originates under the proposed RBC**. NCUA's proposal results in identical institutions – a bank/thrift and a CU – with identical balance sheets having different RBC requirements based solely on their charter.

Self-Help, which has supported research and advocacy on behalf of the credit union charter, believes that risk weights that exceed bank requirements incent credit unions to explore charter conversions, as the additional earnings requirement to build capital could somewhat off-set the tax advantage that credit unions have over banks and thrifts. Provided that the risk weights and capital thresholds are the same for a credit union and a thrift or bank, there is no defensible reason a credit union can articulate that a charter switch would benefit members.

Furthermore, NCUA fails to either articulate the specific quantitative analysis behind such concentration calculations or reduce RBC for any risk-mitigation a credit union undertakes – whether such mitigation is the use of derivatives to reduce interest rate risk or tighter credit

standards (low LTV, geographic diversification, higher credit scores, etc.) that reduce credit risk associated with "concentration risk".

Since the failure of the corporate credit unions, which were over-invested in risky private label mortgage-backed securities, NCUA has per se presumed that concentration in a single market is a risk unto itself. It was not the over-investment in mortgage assets that caused the failure of the corporate credit unions, Fannie Mae, Freddie Mac, Countrywide and Washington Mutual. All of these institutions invested in mortgage products – securities backed by stated income loans and 2/28 ARMs – that were certain to fail. Had each of them solely invested in fully-documented, 30-year purchase money or non-cash out refinance mortgages and held adequate leverage capital, they, like institutions that avoided these destructive products, would have survived the financial crisis. Few, if any, significant natural-person credit unions that were primarily invested in fully-documented, conventional loans failed during the crisis, including credit unions that saw their leverage capital substantially depleted by provisions for loan loss during the height of the crisis. Some of the more significant failures and near failures – Norlaco, St. Paul Croatian, Cal State 9, among others – were all the result of fraud or unsound investments in non-conventional products.

While Self-Help supports a stronger RBC standard to reflect the differentiated risk between credit unions, we believe that regulators and financial institutions should primarily focus on a credit union's net worth-to-asset ("leverage") ratio as the primary measure of risk protection rather than developing complex, subjective models that give the appearance of measuring risk without actually doing so. The financial crisis of the past decade demonstrated unequivocally that complex, risk-based models are inefficient measures of risk compared to ensuring that financial institutions accumulate adequate leverage capital. Fannie Mae, Freddie Mac, Lehman Brothers, Wachovia and dozens of other financial institutions around the world all had adequate "risk-based capital" under Basel I, Basel II, internal and other models right up until they failed. In virtually every instance, a lack of core, leverage capital proved to be their critical undoing.

Instead of attempting to use a complex, untested model to quantitatively layer in interest rate and concentration risk, Self-Help encourages NCUA to supervise those risks. NCUA should be insisting that credit unions with high interest rate risk have sound ALM planning and risk mitigation through the use of derivatives and other tools, rather than penalizing credit unions for taking the risk itself. Similarly, NCUA should have strong supervision of credit unions, like Self-Help, that are focused on mortgage and/or member business lending and ensure that those credit unions are adequately underwriting, pricing and managing the credit risk associated with those concentrations.

Finally, we believe that NCUA is erroneous in its analysis of the amount of capital that credit unions would have to raise to off-set the increased requirements under the proposed risk-weights. Self-Help FCU's board has established a 12% leverage ratio target, recognizing the unique risks associated with lending to low- and moderate-income families. If Self-Help FCU's RBC requirement was 10.5%, the board would likely propose that we hold closer to 15%-16% risk-based capital rather than being satisfied with 10.5% RBC. Very few credit unions are comfortable managing close to the well-capitalized standard on either leverage or risk-based capital. In order to accumulate sufficient capital to maintain buffers, most credit unions will increase loan rates and fees and/or reduce savings rates.

**<u>A credit union's NCUSIF deposit should not be deducted in the RBC standard</u>**.
Self-Help generally agrees with NCUA that intangible assets should be excluded from risk-based capital. We agree with NCUA's recommendation to exclude true intangible assets, including goodwill, from the RBC calculation. These assets do not have financial value to the credit union nor do they have liquidation value to the NCUSIF itself.

Having completed thirteen mergers and acquisitions since credit unions were required to switch from the pooling of interests to the purchase method of merger accounting, Self-Help is well aware of the fact that intangibles such as goodwill and core deposit intangibles have no real value in the market. For that reason, we have exercised our option under the new private company accounting standards to amortize goodwill acquired in mergers over five years beginning on January 1, 2014. While doing so substantially reduces net income in the short-term, we do not believe goodwill has any real economic value to the credit unions and its members, and therefore wish to write it off as soon as practicable.

However, a credit union's NCUSIF deposit has potential tangible value to the credit union, in that NCUA has occasionally paid dividends on that deposit that outweigh the total assessments charged for natural-person CU losses.

More importantly, that deposit has tangible value to the NCUSIF itself in the event of a credit union's failure. **The primary purpose of capital – leverage or risk-based – in an insured depository is to protect the insurance fund, not the depositors/members.** NCUA has taken the legal position that the FCU Act itself requires the agency to liquidate/assess the specific NCUSIF deposit of a failed credit union before it assesses the broader share insurance fund. So long as NCUA maintains that legal position, it is not reasonable to claim that the NCUSIF deposit itself is an "intangible" asset in a capital calculation that exists to protect the share insurance fund itself.

**<u>The threshold for subjecting a credit union to RBC should be $250 or $500 million</u>.**
NCUA has rightly recognized that the largest credit unions present the greatest risk to the NCUSIF itself, and therefore, should be held to a higher-standard of regulation and supervision. Whether through the creation of the ONES office, stress-testing of $10 billion+ credit unions or the assignment of special examiners – problem case officers, regional lending specialists and regional capital market specialists – to large and/or complex credit unions, NCUA has prudently developed a more risk-focused supervision program in recent years.

At the same time, smaller credit unions, which create relatively little risk to the NCUSIF, have suffered from much of the same increased regulation that larger credit unions are subject to, whether those regulations have come from NCUA or other agencies, like FinCEN.

In Self-Help's experience, the vast majority of credit unions as small as $50 million or $100 million in assets are neither complex nor sophisticated in their financial planning, forecasting or analysis. NCUA's standard for applying a **regulation** to credit unions, particularly under its Title II authority as insurer, must be whether the vast majority of institutions subject to that regulation

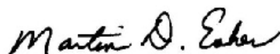
would be materially safer as a result of the regulation. We do not believe NCUA has demonstrated that setting the threshold at $50 million meets this test.

NCUA has already set a different standard on financial reporting for large and small credit unions. For example, credit unions with more than $500 million in assets must obtain a CPA opinion audit, whereas credit unions under $500 million can generally satisfy their audit requirement with a supervisory committee audit. NCUA has the discretion to require credit unions under $500 million to have an annual CPA opinion audit, but has recognized that broadly burdening all credit unions under $500 million with such a cost is not worth the benefit it provides to the NCUSIF.

Of equal significance, credit unions under $500 million in assets make up a relatively modest share of total insured deposits. By NCUA's own reporting, credit unions over $500 million in total assets account for 67% of total system assets. Raising the threshold to either $250 or $500 million would reduce the potential regulatory burden for largely non-complex credit unions with limited financial forecasting capacity without adding material risk to the NCUSIF.

Thank you again for the opportunity to comment on the proposed risk-based capital standards. While we support NCUA's effort to modernize risk-based capital, we strongly encourage the agency to match the Basel III risk weights on mortgages and MBLs, consistent with how U.S. banks and thrifts are regulated, rather than penalizing credit unions for competing for those same loans and to consider our recommendations regarding the NCUSIF deposit and the asset threshold for applying RBC.

Sincerely,



Martin Eakes
Chief Executive Officer

Randy Chambers
Chief Financial Officer