Meritrust
CREDIT UNION

Meritrust Credit Union
PO Box 789757
Wichita, KS 67278-9757
800.342.9278 P
meritrustcu.org

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

Meritrust Credit Union
Charter: 63283

Dear Mr. Gerard Poliquin:

The purpose of this letter is to express comments on the NCUA Proposed Risk-Based Capital rule.

I am writing on behalf of Meritrust Credit Union. Meritrust is a $975 million community chartered credit union serving seventeen counties and 1,000,000 Members with 14 branches. The following is a very brief overview of Meritrust:

- We have a 98% loan-to-deposit ratio
- Our loans-to-assets ratio is 84%
- Following is our loan penetration as a percent of assets:
    - 58% Consumer Auto Loans (primarily auto loans)
    - 18% Residential Real Estate Loans
    - 4% Member Business Loans
    - 3% Consumer Credit Cards
- Our net worth ratio is approximately 10%
- We have been a Member business loan lender for the past 10 years. Given the size of our portfolio and the length of time successfully being a Member business loan lender, we are a resource for the credit union community while minimizing our risk position

There are many good reasons for risk-based capital standards; but, overall, this rule is overkill and potentially harmful to the industry. The credit union industry weathered the worst financial crisis in 80 years, and it appears this proposed rule is an over-reactionary attempt to prepare for a worse event while ignoring the experience gained during the crisis.

Every credit union has a variety of risks inherent within their balance sheet, the greatest of which is Credit Risk. The failure to adequately manage Credit Risk has resulted in most, if not all, Credit Union failures. Therefore, credit risk should be the focus to prevent this type of failure in the future. Unfortunately, the proposed risk-based capital (RBC) rules fall short in several areas, while attempting to mitigate nearly every type of risk with a broad swiping regulation. Similar to wearing cowboy boots for a track meet….

Below is a summary of our main concerns:

- The new rules do not consider all investments guaranteed by federal government-sponsored entities (GSEs), like Federal Home Loan Bank, Fannie Mae and Freddie Mac. These are extremely low risk, have had no history of losses and compare well to the other assets within this group. We believe that the higher weighting for longer term GSE investments is not necessary since interest rate risk management is already covered by other regulations and the interest rate risk may be partially or completely hedged on the balance sheet. This would also be consistent with allowing longer-term US Treasuries in Category 1 (0% risk weight). We would also add a category for US Public entities like States and Municipalities.

- We recommend considering CUSO investments at a lower percentage as these investments are a good strategic partner for many credit unions that add good returns at a moderate level of risk and there are already regulatory limits in place for CUSOs.
- We agree that complex asset-backed investments (private label) that have inherent credit risk exposure should have some additional due diligence requirements. However, we believe that this penalty percentage is too large for this asset group considering the arbitrary assumption of inadequate due diligence. Generally Accepted Accounting Principles already require mark-to-market accounting for any of these investments that are impaired. Therefore, I believe a 250% weighting would be much more appropriate. We also believe the rule needs to make it clear that this does not include any asset-backed investments that are guaranteed by the US Government of any Federal Government Agency.

Our biggest concern with the proposed rule is the weighting of Member business loan concentrations. As the percent of Member business loans to assets increase, so does the risk weighting. In the next few paragraphs, we lay out our rationale as to why the added concentration is not a risk and, in some ways, could be looked at as a lower risk due to the high level of expertise and policy limitations/parameters that are needed to monitor a large concentration. Said another way, the "real life" expertise needed to oversee a portfolio with a 40% concentration is much higher than what is needed for a portfolio less than 15%.

- The Member business loans risk weightings in the proposed rule are much more punitive than Basel III due to NCUA's approach to increase the risk weighting based on concentration levels. The definition of concentration is the lack of diversification. We would argue that we have a lot of diversification in our Member business loan portfolio. Our Member business loan portfolio is comprised of many different "types" of loans each carrying their own risk levels.
    - By board policy, we limit the total amount of Member business loans as a percent of total loans and as a percent of net worth.
    - By board policy, we limit the amount of Member business loans by NAICS codes. NAICS codes identify the type of business such as restaurant, lessors of residential real estate, entertainment, wholesale, etc. We would be happy to help NCUA develop such a matrix.
    - By board policy, we further limit the concentration of NAICS codes as a percent of net worth. Policy allows for a greater concentration (as a percentage of net worth) of historically very low risk loans than industry types that carry a higher historical loss ratio even though these higher loss ratio loans are priced accordingly.
    - By board policy, we limit the concentration of NAICS codes as a percent of total Member business loans.
- The rule puts the same risk weight on all Member business loans. As mentioned above, all Member business loans do NOT carry the same amount of risk.
    - A Member business loan secured by a 4-family rental property with a good risk rating and a low loan-to-value (LTV) is weighted the same as a higher NAICS risk loan with an average risk rating with an 80% LTV.
    - Rather than place a blanket weight on the entire portfolio, a weight should be based on national historical loss ratios by NAICS codes. Our history along with industry averages indicate certain NAICS codes are less risky than a vehicle loan (the proposed rule has a risk weighting of 75% for vehicle loans). To properly assess Member business loan risk, the call report must be expanded to report the correct information.
- The proposed rule, by increasing the risk weighting over and above the Basel III levels, seems to indicate that NCUA feels Member business loans carry a greater risk. We contend this is factually inaccurate.

Other general observations with the proposed rule are:

- The proposed rule would negatively impact the Members and the current net worth cushion most credit unions currently enjoy.
    - We currently have a 400 basis point cushion over the well capitalized 7% requirement. If the proposed rule is enacted as written, we would fall to 17 basis points below the 10.50% risk-based well-capitalized requirement.
    - According to CUNA, 1,643 of 2,504 credit unions will see their cushion above well-capitalized decrease.
    - Net interest margin compression will likely continue; so to replenish this net worth cushion, credit unions would most likely look to fee income. Fee income is not only bad for the Members, but it is also bad for the credit union industry in the long run.
    - Meritrust feels to be competitive for the long run, we need to reduce our reliance on fee income. This is being achieved by expense reduction and aggressive balance sheet management.
- The proposed rule has a 12- to 18-month transition period, which is much shorter than the Basel III 5-year transition.
    - Credit unions do not have the ability to raise capital similar to banks. As such, the proposed rule should have a longer transition period than banks.

The proposed rule has also been reviewed by firms outside the industry, and they understand this may require credit unions to look at their business model and to consider changes to their charter. We already have been contacted by a firm specializing in charter changes. Meritrust Credit Union is proud of what we do for our Members and the value we place on their relationships. By restricting our historically successful business model, we could be forced to look at all our options. Our healthy and successful Member business loan program has generated the cash flow to support our large number of retail and school site branches, to support our deep community involvement, etc. If we needed to curtail our Member business loan program, we would be a different and less successful credit union.

In summary, we would encourage you to ponder the following two statements:

1. Member business loans, in and of themselves, do not carry a greater inherent risk than other lending products. Our experience clearly and objectively proves this statement. This rule must be rewritten to place the appropriate amount of risk on this product.
2. The proposed rule is more restrictive to the credit union community than the Basell III rules are to the banking community. NCUA needs to explain and quantify why they feel the credit union rule must be more restrictive.

I am available for questions at 316-651-5137 or Mahlon.mccaleb@meritrustcu.org and we appreciate the opportunity to provide comments on this proposed rule.

Sincerely,

Mahlon McCaleb

Mahlon McCaleb
SVP – CFO
Meritrust Credit Union