Citadel

daily banking

investments

loans

insurance

May 23, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

RE: Proposed Rule on Risk Based Capital RIN 3133-AD77

Dear Mr. Poliquin:

Citadel was established in 1937 as the credit union for Lukens Steel in Chester County Pennsylvania. Since obtaining our new Community Charter in 2009, we have expanded our member base throughout Bucks, Chester, Delaware, Montgomery, and Philadelphia Counties. Today, we proudly serve over 122,000 households and approximately 400 partner businesses, organizations, and companies. At nearly $2 billion in assets, we are one of the largest locally managed financial institutions in the greater Philadelphia area.

Citadel Federal Credit Union (Citadel) appreciates this opportunity to comment on the National Credit Union Administration's (NCUA) proposed rule on Risk-Based Capital (RBC).

There are several areas of concern in the NCUA's risk-based capital rule that we feel need to be taken into consideration prior to issuing a final ruling.

CUSOs

The 250 percent risk-weight for investments in CUSOs is arbitrary, lacking insufficient rationale, and does not reflect the actual risk of investing in CUSOs. If, for example, the CUSO is successful, generating profits, and increasing its net worth, this would result in increased reserves under the new rule, instead of recognizing that the reserves should be lowered based on the fact that the credit union's investment is sound and presents a safe level of risk.

CUSO investments should be on a sliding scale based on the performance of the CUSO and the associated risk.

Any exceptions to potential credit union risk should be managed through the examination and supervision process and not by a system-wide capital regime.

520 Eagleview Boulevard Exton, PA 19341
(800)666-0191 CitadelBanking.com

Investments

The proposed rule would unfairly penalize credit unions and it shows bias towards lending and against investments.

The current risk-weights do not accurately reflect the interest rate risk for short-term and middle-term investments, such as those under a 5-year maturity.

The proposed rule does not factor in credit unions' interest rate exposure offsets, such as variable rate assets or derivatives. In any final rule, the NCUA needs to include a way to factor in the interest rate risk mitigation being done by credit unions.

Credit unions already monitor and control for interest rate risk through their own policies and in accordance with the NCUA examination and supervision. It is not necessary for a risk-based capital regime to perform this function. If the NCUA keeps interest rate risk built into investment risk-weights, that system should not penalize short or medium term investments. An alternative model could condense the investment categories into a smaller number of buckets and allow short-term and mid-ranged investments to be appropriately measured. This alternative structure would still capture the long-term investments that would raise the most interest rate risk flags.

That system could look like this:

0-5 years: 20 percent
5-10 years: 100 percent
>10 years: 200 percent

This would be preferred over the proposed rule and it is an alternative risk-weight system for investments that does not penalize credit unions for **all** investments with a maturity over one year.

Non-Delinquent First Mortgage Real Estate Loans

The proposed risk-weights for non-delinquent first mortgage real estate loans are too high and penalize too many credit unions for concentrations of loans that are not inherently risky.

An alternative structure, that still incorporates an element of concentration risk for non-delinquent first mortgage real estate loans, would be to reduce the number of concentration risk buckets from 3 to 2 and introduce larger ranges of asset concentrations.

The risk-weights do not take into consideration any factors that could indicate that the loans are more or less likely to default, including the loan-to-value ratio of loans or credit scores of the members getting the loans. These factors should be used to lower the amount of capital required to be held for loans that are safer compared to others.

The weights should more closely resemble the FDIC risk-weights. One alternative would be for NCUA to eliminate one of the buckets from the proposed rule and adjust the risk-weights to more accurately reflect the risk involved with non-delinquent first mortgage real estate loans.

An alternative risk-weighting system could look like this:

< 30% of assets: 50 percent
> 30% of assets: 75 percent

Compared to the proposed rule, this result would benefit the capital cushion for credit unions at every asset size level. It would also allow NCUA to continue their control of concentration risk by requiring credit unions to hold more capital if they hold heavy concentrations of real estate loans, without straying far from the FDIC risk-weighting (50 percent).

Mortgage Servicing Assets

If imposed, a 250 percent risk-weighting on mortgage loan servicing assets would be artificially high and excessive.

Eliminate the risk-weights for mortgage servicing assets.

Incorporate recourse into the equation when determining the risk-weight and allow a lower weight of 100 percent if the loans are sold without recourse, but continue to be serviced.

Member Business Loans (MBLs)

NCUA's proposed rule on risk-weights for MBLs is punitive for credit unions chartered for the purposes of MBLs.

NCUA should provide credit unions chartered historically for business loan purposes a different set of risk-weights, that do not require them to abandon their core mission for their membership; and their MBL portfolio should be given a risk-weight of 100 percent and managed through examination and supervision.

Any final rule should give credit to credit unions with proven minimal losses in business lending.

Risk-weights should also be broken down for different types of loans, such as, agricultural MBLs or commercial real estate MBLs.

Corporate Paid-In Capital

Corporate paid-in capital is risk-weighted too high at 200 percent.

Paid-in capital would be more appropriately weighted at 125 percent to recognize that the corporate credit union structure is now a less risky asset than it was during the crisis.

A weight that reflects the actual risk for paid-in capital to corporate credit unions would benefit natural person credit unions, corporate credit unions, and the Share Insurance Fund.

Individual Minimum Capital Requirement

There are serious concerns about the legal authority of NCUA to enact individual minimum capital requirements. There are two main legal issues. First, is the ability of the NCUA Board to even institute individual minimum capital requirements, and the second is whether they can delegate that authority to anyone besides the NCUA Board, such as an examiner or regional director.

This portion of the regulation undermines the entire purpose of the rule. On one hand, the NCUA is stating that the risk-weights are designed specifically to factor in a number of risks, including concentration risk, interest rate risk, credit risk, market risk, operational risk, and liquidity risk. On the other hand, if the NCUA decides that their risk-based capital ratios do not do what they are designed to do, then the NCUA can just change the rules for an individual credit union. How are credit unions supposed to make business decisions regarding their portfolio and adhere to the standards laid out in the rule with a continuously moving set of rules? The difficulty for credit unions is compounded when the rules can change. This provision just adds uncertainty to credit union management.

The appeals process does not alleviate any of the underlying concerns with this part of the rule, and needs to be revised to provide for an independent resolution. The process itself burdens individual credit unions to prove that the NCUA action was not an appropriate exercise of discretion by the NCUA. More troublesome, is the fact that the process also requires credit unions to appeal to the same NCUA Board that made the judgment in the first place. While the proposed rule allows credit unions to seek the opinion of the NCUA's Ombudsman, the NCUA Board is not bound by or required to give deference to the Ombudsman's recommendations. An independent appeals process, where the ultimate deciding body is not the same NCUA Board that made the decision, is a more fair structure for credit unions.

This section should be removed from any final rule.

Implementation Period

The 18-month proposed implementation time period is not nearly enough time for credit unions to make changes to their balance sheets in a safe and sound manner.

Any implementation period should be at least three years from the passage of any final rule, which would give credit unions enough time to raise capital through retained earnings or make changes in their operations.

A 3-year implementation period compares more appropriately to the timeframes given by regulators to the banking industry during the implementation of the BASEL standards.

Supplemental Capital

Supplemental capital authority is needed now more than ever, considering the restrictions brought on by this rule.

Supplemental capital authority is not the answer to the entire industry's worries about capital, but it is a powerful tool that should be given to all credit unions.

NCUA should call on Congress to pass a legislation solution that modernizes capital standards to allow supplemental capital and directs the NCUA Board to design a risk-based capital regime for credit unions that takes into account material risks, instead of the current proposed rule.

Goodwill

Removing Goodwill will negatively affect credit unions that have gone through recent mergers, by failing to allow them to fully realize the previously accounted for benefit.

Removing Goodwill will present a disincentive for healthy credit unions to become merger partners for troubled or failing credit unions, because of the possible significant negative effect to their risk-based net-worth ratio. The credit union industry has seen significant consolidation in the past few years and this is a trend that is likely to continue. Without Goodwill available to help balance out the equation going forward, a healthy credit union is less likely to agree to take on a troubled credit union as a partner (even at the request of NCUA). This is going to make it more difficult and more expensive for NCUA (and the industry as a whole) to find merger partners for troubled or failing credit unions, which will ultimately lead to more costly liquidations for the Share Insurance Fund.

Goodwill should be added back into the numerator for the risk-based capital ratio.

Conclusion

The NCUA Risk-Based Capital rule, as presented, puts credit unions at a competitive disadvantage at a time when growth in the industry is vital to its survival. It is understood that capital requirements are necessary, but they should not prohibit management's ability to make rational business decisions. Risk-based capital is good and necessary to keep our industry healthy, if applied appropriately.

In recent years, NCUA has increased its regulation and scrutiny on interest rate risk and liquidity. Risk-based capital, in its current form, defies common sense. It undercuts management's discretion in terms of risk management. We ask that NCUA make extreme changes of the rule in its current state that will help to provide clarity and fairness.

Thank you for this opportunity to respond.

Sincerely,

Maria F. Steffy

Maria F. Steffy
CFO