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

Sent via e-mail to: regcomments@ncua.gov

Dear Mr. Poliquin,

This letter represents the views of Members Choice Credit Union regarding the NCUA's proposed new regulation for Prompt Corrective Action ("PCA") and a change to the existing Risk-based Capital ("RBC") standard. Members Choice is a state-chartered, federally-insured community credit union based in Houston, Texas, which serves over 41,000 members. We appreciate the opportunity to comment on this very important issue.

ENTERPRISE RISK MANAGEMENT (ERM) vs. RISK-BASED CAPITAL (RBC)

Let me begin my comments by stating that we believe NCUA got it right by establishing the need for an Enterprise Risk Management (ERM) system in credit unions, scaled to the size and complexity of the institution. This requirement was communicated in NCUA's *Letter to Credit Unions 13-CU-12; Supervisory Guidance on Enterprise Risk Management.*

A well-designed ERM should, by definition, identify levels of risk imbedded in a credit union's balance sheet and business model. Our ERM program is designed to identify various risks, including the level of risk in components such as credit risk, interest rate risk and liquidity risk; categories that all fall under the CAMELS model used by both bank and credit union examiners. Although we do not have excessive risk in these categories, we'll be adversely affected by the new NCUA RBC model.

We believe the problem is NCUA's broad "one size fits all" approach to balance sheet management. Additionally, this regulation would empower field examiners to arbitrarily reclassify capital ratings for credit unions that are well-, or adequately-capitalized by standards set by the Federal Credit Union Act.

WHY THE BANK VERSION OF RBC FAILED DURING THE LAST RECESSION

For many years, commercial bank regulators have maintained a risk-based capital standard for banks that included capital requirements for Tier-1 and Tier-2 capital. These definitions were the result of Basil I and Basel II meetings and were established before the most recent recession of 2008-09. However, because U.S. commercial banks were not required to raise their leverage ratio (the equivalent of our "net worth" ratio), even some "well capitalized" banks were unable to sustain their operations without $800 billion in TARP relief.

As a result, experts in the bank regulatory arena are now suggesting that revising the minimum leverage capital ratio may serve the industry better in the long run.

For example, in its April 2013 economic letter, the Dallas Federal Reserve Bank published an article by financial industry analyst Michael A. Seamans titled, "When Gauging Bank Capital Adequacy, Simplicity Beats Complexity." An excerpt…

> "Financial crisis experience suggests it is unclear whether ratio complexity enhances the ability to identify failure and is better than a simpler ratio. But a simpler ratio offers the benefits of greater transparency and accountability...In essence, greater capital ratio complexity doesn't make the task of identifying future bank failures any easier."

And then there's this…

From Charles I. Plosser, president of the Federal Reserve Bank of Philadelphia, who offered the following comments in a June 6, 2013, speech to the Boston College Carroll School of Management, titled, "Reducing Financial Fragility by Ending Too Big to Fail":

> "There is probably no better example of rule writing that violated the basic principles of simple, robust regulation than risk-weighted capital calculations. Now Basel III requires 616 pages to provide guidance on risk-weighted capital. We have a wealth of examples in which risk-weighted capital rules have permitted very risky activities by institutions with little or no capital. In addition, there is evidence that even for relatively simple portfolios the measure of risk weighted assets can vary significantly across banks."

These bank regulatory experts are acknowledging the shortcomings of the current bank risk-based capital methodology and are encouraging discussion as to the value of increasing bank leverage ratio requirements to reduce systemic risk to the economy.

Yet, our federal credit union regulatory agency finds it necessary to move the credit union industry to a new RBC standard, when we already have the highest leverage ratio requirements in the nation. Higher than corporate credit unions, higher than community banks, and higher than "Too Big to Fail" banks, who have much more complex business models and significantly higher levels of on and off-balance sheet systemic risk.

IS THIS PROPOSED REGULATION IN LINE WITH THE SPIRIT OF THE LAW?

Recently, the Credit Union National Association (CUNA) in a May 15, 2014, newsletter, noted that this regulation represents a violation of the Federal Credit Union Act. The act directs the NCUA to set any risk-based component for the well-capitalized threshold no higher than the component for the adequately capitalized level.

In addition, in a recent comment letter to NCUA, former U.S. Senator D'Amato (NY) noted that it was not the intent of Congress in 1998 (when the Federal Credit Union Act was last modified to create the current PCA capital requirements) for NCUA to create a second PCA standard for credit unions.

Apparently, had that been the intent, it would have been written into the Act.

LACK OF A "LEVEL PLAYING FIELD"

In reviewing the proposed NCUA RBC model and comparing it to the proposed Basel III RBC standard for small banks, we have determined there are significant differences in the risk-weighting of assets.

The only area where there is an advantage to a credit union is in the risk-weighting for non-delinquent consumers loans (75% weighting for credit unions compared to 100% for banks). In most other categories, including investment portfolio, first and second lien mortgage loans, business loans, and delinquent consumer loans (secured), credit unions are held to a higher standard, which simply means we will need to hold a greater amount of capital compared to banks for these asset types.

It should also be noted that at a time when credit union consultants and industry experts are encouraging credit unions to collaborate in order to succeed in the future, the NCUA is placing the highest weighting (250%) on investments in Credit Union Service Organizations (CUSO).

These differences are troubling and will further damage the credit union charter (as these changes are in addition to the existing regulatory business loan cap, lack of access to supplemental capital and field of membership restrictions). In addition, we believe NCUA has not done an adequate job in justifying the differences in the weightings. This is particularly disconcerting, given the superior overall delinquency and charge-off rates for credit unions vs. banks since the "Great Recession," and the number of banks that took TARP funds or failed since September 2008.

Further, bank regulators are giving community banks until 2019 (five years) to restructure their balance sheets, while NCUA is giving credit unions 18-months. This shorter timeframe may create the need for unnecessary losses to credit unions selling Available for Sale (AFS) securities or real estate related assets in their effort to better align with this new RBC standard.

UNINTENDED CONSEQUENCES

We believe this proposal is fundamentally flawed. During this comment period, we have already heard from the second largest credit union in the nation, who stated publicly they may need to consider a change to a bank charter if that is in the long-term best interest of their members and their organization.

Would there be additional unintended consequences as a result of this regulation as more of the large, complex credit unions change to a bank charter? How would state and national trade associations be impacted due to a decline in revenue? What impact would this have on the National Credit Union Share Insurance Fund (NCUSIF) as the NCUA refunds millions of dollars in share insurance fund deposits to credit unions converting to FDIC coverage? Would the loss of financially strong credit unions decrease credit union merger options at a time of industry consolidation?

Clearly the United States Congress is concerned about the impact this new regulation would have on small business owners and credit union members. This is evidenced by signatures of 75% of the members of the U. S. House of Representatives (both Democrats and Republicans) in a letter to the NCUA board. This concern was also recently shared in a comment letter by U. S. Senator Franken (MN).

Thank you for this opportunity to share our thoughts regarding this proposed risk-based capital regulation. We hope our concerns are given due consideration as this regulation has the potential to be the most damaging regulatory action by the NCUA in recent history.

Sincerely,

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cc: U.S. Senator John Cornyn
U.S. Senator Ted Cruz
U.S. Representative John Culberson
U.S. Representative Michael McCaul
U.S. Representative Pete Olson
Credit Union National Association
Cornerstone Credit Union League