We would like to exercise our responsibility to comment on the proposed Risk Based Capital Rule, RIN 3133–AD77 that is in the comment period with the following facts and questions to insure that the issue is properly vetted. I represent M-C Federal Credit Union and our 11,500 members, $127 million in assets, well capitalized position, Rural SEG Based Credit Union in rendering these comments. We report in the $100 / $500 million peer group.

The objective stated in the proposed rule is to promote consistency within businesses that clearly have different business objectives, business models, and business owners, operating rules, and operating regulators. The proposed rule as presented should be withdrawn because it cannot meet the stated objective. Congress, who structured the financial services systems and regulatory structures, did so with different focuses and rules in the business segments. If they would have envisioned one business model they would have defined it, created the appropriate legislation to regulate it and moved on. In your attempt to emulate the risk based capital structure of banks, you are changing the capital requirement for being well capitalized as defined in the federal credit union act. Only Congress has the authority to change the capital requirements as defined in the act. The proposed rule violates the law and your authority and should be withdrawn.

The objective also focuses on redefining risk based measures to specific asset classifications but has failed to build a case to support their position. We are in agreement that the current risk ratings are inconsistent within the current model. At my credit union we participated in the purchase of the NCUA guaranteed notes, collateralized with mortgages that have a zero risk weighting. We also participate in GSE Mortgage backed Securities that hold the same guaranty and risk profile, however they are risk rated. What are the specific drivers that determine the risk weighting? In this example we struggle to see the difference in risk to the credit union; therefore the risk rating should be the same, zero. This example would suggest the risk assignments are arbitrary. They should be evaluated based on the risk profile of the investment or loan.

We take exception that any security or loan that we have on our balance sheet that has the name mortgage in it, be it an Adjustable Rate Mortgage, Mortgage Backed Security, Fixed First Mortgage, or Collateralized Mortgage Obligation is burdened by excessive risk rates and is aggregated under a concentration risk umbrella. There is a clear difference in the risk profiles of each of these groups; the system fails to assign risk based on the risk profile. It is clear that the intent of the risk ratings you seek to penalize Credit Unions who diversify their portfolio by virtue of the behavior of the securities and aggregate it into high risk component ratings if it has any association to the word “mortgage”.

During the great recession our credit union held a diverse position of these assets and built capital through focused risk management of the portfolio. This is our accountability to measure, monitor, and manage risk. We were doing our job. The strategy for a SEG based rural credit union must have a diverse portfolio that is even more critical in this low rate environment based on the security that mortgage products offer. This rule forces us to shift the focus of our business focus from serving our members to serving the masters capital number. As we read the Federal Credit Union Act that is clearly not the objective of the founders.

Let’s turn your focus to the industry performance during this period of time;

Question: Was the Credit Union capital reserves adequate to protect the industry during the financial crisis we just exited? As an industry we did rather well. Why? Because the risk based capital structure was properly focused. Why is this fact important? Because it is the actual test results. It is not a simulation or a hypothetical situation. It is the actual result and we passed the test. This would validate that the current system is performing the task it is intended to and there is no justification to recreate a system that has done what it was designed to accomplish.

We also take exception to the characterization that very few credit unions will see a change in their well-capitalized position. In my credit union we currently have a 216 BP cushion over the risk based requirement. This represents a 34% safety net. Under the proposed rule we will have a 31bp or 3% safety cushion. It would take us $3.3 million dollars of additional reserves to have the same safety position as we have under the current system. The only way we will be able to accomplish this is at the expense of our member’s; higher fees, less favorable rates, and the elimination of services. The proposed rules force us to refocus our business model to hitting the RBC number instead of serving members and promoting thrift.

In fact one of the stated objectives you have defined is to align our risk based capital structure more consistent with the measures used by banks. A key part of managing risk is to understand the competition and based on my analysis; they failed. Their system was inadequate and it failed the test. As a result the government had to commit trillions of dollars to stabilize their space. TARP was the answer to a failed bank capital structure. Is this the system you chose to align us to?

As a result Congress acted. They addressed the problem at the root cause not on the back end as your proposed rule does by burdening Credit Unions with creating excessive reserves for that what if day. That day came and went and we were fine. Perhaps the door can be opened for alternate capital as an enhancement to a strong capital system. This would make a strong system, stronger.

We have been overwhelmed with changes relating to these root causes of the crisis. Ability to pay regulations, appraisal process changes, and registration of mortgage originators are all a result of the crisis. The point is that Congress has taken some very aggressive actions to “ensure this never happens again”.

So Congress has taken action to fix the problem. The risk based structure of credit unions was adequate to handle the crisis; there is no case to impose a disruptive change to the industry. This is not justified and will result in forcing many credit unions to abandon their member focus just to satisfy their examiner.

The notion that an examiner can determine the capital requirements for a credit union is alarming. The subjective nature of this authority in the hands of an untrained examiner concerns me. In a board meeting a supervisory examiner responded to a board member when asked “what level of improvement we needed for her to be comfortable that we had control on delinquency” she responded a teensy bit. In this world of modeling, data driven decisions, and active management, we could not fathom how to quantify “a teensy bit”. This is the problem when you stray into the land of subjectivity with people who are not adequately trained.

Question: How does this impact our current strategies for diversification and growth? Under the proposed rule growth is not an option. If we were to execute our loan growth plan we would drop below the 10.50% threshold. Under the existing system we would be fine. So the fact that I am well capitalized today is very misleading. As with many credit unions we will be forced to not grow while we fortify our capital positions. Without growth comes extinction.

To show one of the gross misrepresentations in the logic we pose this question: Why is our risk higher for a 5 and 1 ARM on a 4 unit that is member occupied; and the 5 and 1 ARM on the unit next door that is not member occupied? The answer is it is an MBL. Frankly that is the wrong answer. There should not be any difference in the risk. These are real estate secured loans. There needs to be a distinction in the MBL section that defines the loan type by risk profile. An MBL for a 4 unit rental has a very different risk profile then an MBL for a restaurant.

In summary we understand and support a risk based capital structure. The one we have been operating under is strong and has stood the test of the great recession. There is some fine tuning to the risk assignments within it that should be addressed, but a total rewrite is not justified. The model you have selected, the failed RBC structure for banks; forces Credit Unions to abandon the core philosophy of people helping people and promoting thrift. This rule forces us to manage our business to meet the RBC number not the needs of our members. This rule forces us to establish excessive reserves on the backs of our members. This rule will alter our ability to grow a diverse portfolio and member value. This rule will hurt the 100 million Credit Union members and force many Credit Unions to change their business focus. This rule steps beyond your authority as a regulator.