May 28, 2014

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

RE: Comments on Proposed Rule
Prompt Corrective Action - Risk-Based Capital; RIN 3133-AD77

Dear Secretary of the Board Poliquin,

Thank you for the opportunity to comment on the Proposed Rule on Risk-Based Capital (RBC). Dow Chemical Employees' Credit Union (DCECU) is a $1.4 billion, state-chartered, federally insured credit union located in Midland, Michigan that serves 56,000 members. We have modeled the impact of this proposed rule on our credit union and our current assessment reflects a sufficient risk-based capital cushion with no expectation of any concern in the immediate future. However, we would like to comment and suggest modifications to this proposal to ease the burden for all credit unions (CUs,) ensure the safety and soundness of our industry and have a tool that provides a meaningful assessment of the unique risks of each credit union.

In concept, DCECU supports the NCUA initiative to develop a risk-based capital program for credit unions as it is a good foundation for ensuring the strength of our industry. We can appreciate clear, defined guidelines and desire a useful tool to guide business decisions that impact capital. A simplified, one-size-fits-all model, however, might not truly represent all of the risks and uniqueness of each credit union and we wish to share our concerns with this proposal specifically in the following areas:

- **CUs WILL BE DISADVANTAGED RELATIVE TO BANKS**
- **RISK WEIGHTINGS**
- **SUBOPTIMAL RISK ASSESSMENT**
- **TREATMENT OF NCUSIF DEPOSIT**
- **COMPETITION**
- **REDUCED CAPITAL EFFECTIVENESS**
- **INCREASED BURDEN**
- **CUSO INVESTMENTS**
- **TRANSITION PERIOD FOR IMPLEMENTATION**
- **UNDEFINED ABILITY TO IMPOSE HIGHER CAPITAL REQUIREMENTS ON CASE BY CASE BASIS**

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As outlined above, we believe the proposed rule, if implemented, will have the following impact on DCECU and/or the credit union industry as a whole:

- **CREDIT UNIONS WILL BE DISADVANTAGED RELATIVE TO BANKS –** The rule as currently proposed would place DCECU's risk-based capital ratio level at approximately 18.7%. Conversely, if DCECU were using bank rules, its risk-based ratio would approximate 22.4%. These levels provide approximately **20%** more capital cushion when comparing bank risk weightings versus the proposed CU risk weightings. Assuming DCECU is representative of a typical CU, this type of disparity between the two models will likely cause more sophisticated CUs (generally the larger ones) to choose between a CU charter and a bank charter. We believe this would de-stabilize versus stabilize the industry and the NCUSIF. This would be analogous to the dual-chartering system whereby CUs select a federal or state charter based on the factors that benefit their business model.

  Moreover, in order to be competitive with banks on a risk-adjusted basis, CUs will have to charge higher loan rates, pay lower dividends, charge higher fees, limit investments that improve operations/member service (technology, infrastructure, etc.) or in our case, reduce/eliminate patronage dividends that have been consistently enjoyed by our members for the past fifty (50) years.

- **RISK WEIGHTINGS -** The proposed asset risk weightings are far more conservative than what BASEL III requires of our banking counterparts. Regarding this disparity, the NCUA proposal addresses credit, **plus** concentration and interest rate risk, whereas the bank model only addresses credit risk. Consequently, the RBC risk weights proposed by NCUA are equal or higher in every comparable category, with the exception of Non-delinquent Other Loans (see Attachment 1).

  It appears that these higher weightings are not empirically derived. By way of example, DCECU's Non-delinquent 1st Mortgage Real Estate Loan portfolio is approximately 25% (the first tier maximum -- risk rated at 50% and equivalent to BASEL III). If DCECU were to add 10% more loans, or $140,000,000 in 5/1 or 7/1 ARMs, this would be risk-rated at 75%, the same as if these were booked as 30-year fixed rate loans. Inarguably, the interest rate risk profile is definitively different, but appears to be unaccounted for in this instance. If that is the case, then it holds that the additional 25% risk weighting must be due to concentration risk. Additional justification and clarity is needed as to why the proposed risk weights are set as they are.

  Additionally, DCECU has a well-diversified investment portfolio consisting of:

Agency MBS/CMOs	39%
Agency bullets	31%
Corporate securities	22%
NCUA Gtd. Notes	5%
Municipal securities	2%
Asset-backed securities	1%

with a weighted average life of 2.9 years and effective duration of 2.3%. Under the RBC proposal, if DCECU were to experience increased deposits and lower loans of say, $100,000,000, and invested this on average for 6 years it would carry a risk-weighting of 150% regardless of whether this was invested in five of the six categories (not NCUA Gtd. Notes risk weighted at 0%) listed above. In other words, placing 100% of these investments in agency MBS/CMOs (thus increasing the proportion in the above table to 46%) is just as beneficial to investing $50,000,000 each in municipal and asset-backed securities (see table below). The third portfolio would seem to be the most well diversified from an asset allocation perspective, yet all three would carry the same risk weighting. Again, it appears that this might be contradictory to NCUA's intent of penalizing greater concentration (or rewarding diversification). As mentioned previously, additional justification and clarity would be helpful to better help CUs calibrate the proposed risk weights as they are being proposed.

	Original Allocation	100% new money in Agency MBS/CMOs	50% new money in Munis & ABS
Agency MBS/CMOs	39%	46%	34%
Agency bullets	31%	27%	27%
Corporate securities	22%	19%	19%
NCUA Gtd. Notes	5%	4%	4%
Municipal securities	2%	2%	8%
Asset-backed securities	1%	1%	7%

- **SUBOPTIMAL RISK ASSESSMENT -** The multi-dimensional risk weightings (NCUA's RBC proposal includes concentration and interest rate risk, while others do not) lack detailed analysis of loan and investment portfolios that may not provide proper credit for well-managed risk and may result in unnecessarily high levels of RBC with lower member giveback and/or limited product and service offerings to members thus potentially weakening the entire CU system**.**

- **TREATMENT OF NCUSIF DEPOSIT -** We ask that you carefully consider treatment of the NCUSIF deposit. The proposed rule requires the NCUSIF deposit to be deducted from both risk assets and capital (i.e., both the numerator and denominator) which further raises the risk-based requirement minimally by 90 bps (see below):

  Example: CU w/ $100,000,000 in assets and 10% net worth

	Current				With RBC proposal
Assets:	100,000,000	minus	1,000,000	=	99,000,000
Loans & Investments (100% risk wtd.)	99,000,000				
NCUSIF deposit	1,000,000				

	Current				With RBC proposal
Liabilities:	100,000,000				
Shares	90,000,000				
Net Worth	10,000,000	minus	1,000,000	=	9,000,000
Ratio	**10.00%**				**9.09%**
					a 91 bp difference

In DCECU's case this premium increases by approximately 116 bps. In fact, the lower the percentage of risk assets a CU has, the wider this *paradoxical* premium becomes.

Further, this treatment implies that the deposit is not an asset of a credit union which is inconsistent with NCUA treatment of the deposit as a valid credit union asset. Treatment in this manner might also imply instability of the NCUSIF. Does the NCUA feel that the NCUSIF balance sheet is not sound enough that it requires this additional premium to be added on top of the higher (compared to bank) risk weightings? Or does the NCUA feel that the CU industry is unstable enough to warrant this additional premium?

- **COMPETITION -** Disparities from the Basel III standards could place credit unions at a competitive disadvantage in either or both pricing and product/service availability that will adversely impact members.

- **REDUCED CAPITAL EFFECTIVENESS -** It is a well-known concept that risk brings reward in the form of higher returns, which is the only way credit unions can build capital. The proposed rule, in its wholesale limiting of these risks, will likely breed risk aversion and may have the unintended consequence of reducing the credit union industry's capital cushion, not increasing it as the rule hopes to accomplish.

- **INCREASED BURDEN -** Additional call report and other data collection will be required to show compliance with this rule and may be administratively burdensome without adding the expected value. We can support these additional efforts if they accurately assess each individual credit union's risk profile and do not adversely affect healthy credit unions' ability to meet the financial services needs of their members.

- **CUSO INVESTMENTS -** There is a 250% risk weighting for investments in CUSOs. First, holding $2.50 in capital for every $1.00 invested in CUSOs will likely disincent CUs from working together toward mutually beneficial solutions. While DCECU currently has limited CUSO investments (currently only the CO-OP ATM network) and is not adversely impacted under the proposed rule, we do not support what appears to be an excessive risk weighting relative to the risks of most CUSOs. This appears to contradict one of the fundamental principles of the CU movement, "cooperation among cooperatives." There appears to be little justification for this treatment for the majority of CUSOs.

- **TRANSITION PERIOD FOR IMPLEMENTATION -** The FDIC acknowledged that banks would have to transform their operations to adjust to the new BASEL III requirements and allowed banks to prepare over a 7 year period. NCUA, on the other hand, is suggesting a much shorter 12-18 month transition/implementation period.

This seems inordinately short relative to FDIC's position. With the sole source of credit union capital being retained earnings, a longer transition period is needed. We would recommend a 3 year (on the shortest end) and up to a 5 year transition timeframe to allow credit unions to adequately modify their business model to prepare for the new requirements via balance sheet adjustments or to accumulate additional capital, unless the NCUA can articulate the need for a shorter window.

- **UNDEFINED ABILITY TO IMPOSE HIGHER CAPITAL REQUIREMENTS ON CASE BY CASE BASIS** - Discretionary ability to impose higher capital requirements on some credit unions seems problematic as consistency across NCUA examination staff would be difficult to maintain. Also, uncertainty will likely cause CUs to add in additional "buffer" capital to ward off potential debates with examiners. In order to enable credit unions to make good business decisions, all capital expectations should be clearly outlined in advance.

Summary

It is unclear how the proposed risk weightings represent true risks to each individual credit union's capital. Consideration of an experience-based index might be more useful to better capture institution-specific risk. Consideration of each credit union's historical performance (CAMEL ratings) and loss ratios are important factors when assessing risk. In addition, detailed breakdowns of portfolios to include loan and investment terms and not just maturities will more fully recognize true risk. While we are mindful of the necessary balance between the complexity of a model and meaningful output, we believe a multi-level model might capture associated risk more accurately and not be punitive to those credit unions that are managing these risks well already.

Thank you in advance for your thoughtful consideration of the comments expressed above. We are hopeful that the final rule will not be unduly burdensome, will maintain the financial health of credit unions and continue to enable each credit union to meet the unique financial services needs of their members. DCECU wishes to be part of the solution and would be willing to discuss or participate more fully on any or all of the points made above.

Sincerely,

Dennis M. Hanson
President/CEO

cc: U.S. Congressman Dave Camp
U.S. Senator Debbie Stabenow
U.S. Senator Carl Levin
Bill Hampel, Interim President, Credit Union National Association
Dave Adams, President/CEO, Michigan Credit Union League

Attachment 1

NCUA Proposed Rule vs. Small Bank Basel III System Selected Comparisons

		NCUA Proposed CU System weights	Small Bank Basel III Weights
Cash on hand		0%	0%
INVESTMENTS			
Investments: WAL < 1 year	=	20%	20%
Investments: WAL 1-3 years	↑	50%	20%
Investments: WAL 3-5 years	↑	75%	20%
Investments: WAL 5-10 years	↑	150%	20%
Investments: WAL > 10 years	↑	200%	20%
Corporate CU member capital	=	100%	100%
PIC/Perpetual Contributed Capital	↑	200%	100%
LOANS			
Nondelinquent nonfederally GSL	=	100%	100%
Nondelinquent other loans	↓	75%	100%
Reportable delinquent other loans**	↑	150%	100%
Delinquent 1st mortgage real estate*		N.A.	100%
Residential mortgages Guaranteed by FHA or VA	↑	20%	0%
Nondelinquent 1st mortgage real estate loans*			
< 25 % of assets	=	50%	50%
Excess of 25 - 35% of assets	↑	75%	50%
Excess of 35% of assets	↑	100%	50%
Other real estate and delinquent real estate			
< 10% of assets	=	100%	100%
Excess of 10% - 20% of assets	↑	125%	100%
Excess of 20% - 25% of assets	↑	150%	100%
Excess of 25% of assets	↑	150%	100%
Small business administration loans	=	20%	20%
Member business loans/commercial loans			
< 15% of assets	=	100%	100%
Excess 15 - 25% of assets	↑	150%	100%
Excess of 25% of assets	↑	200%	100%
* Excludes MBLs secured by real estate.			
OTHER ASSETS			
NCUSIF deposit		-100%	N.A.
Goodwill		-100%	
Identifiable intangible assets		-100%	
Loans to CUSOs		250%	N.A.
Mortgage servicing assets		250%	Varies
All other assets		100%	
OFF BALANCE SHEET ITEMS			
Loans sold with recourse		75%	Varies
Unfnd commit on business loans (75% conversion)		100%	Varies
Unfnd commit on non-business loans (10%		75%	Varies
ABS "comprehensive understanding" penalty	=	1250%	1250%

****Proposed included delinquent mortgages**