May 27, 2014

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

Subject: Prompt Corrective Action – Risk Based Capital; RIN 3133-AD77

Dear Mr. Poliquin,

Thank-you for the opportunity to offer comments on the National Credit Union Administration's (NCUA) Risk Based Net Worth rule (RBNW). I appreciate the NCUA board and staff efforts to review and update regulations to keep the credit union charter relevant and the National Credit Union Share Insurance Fund (Fund) safe in today's challenging economic environment.

I'm in complete agreement that it is time for the credit union charter to move to a more comprehensive risk-based approach to evaluating the adequacy of capital necessary to operate in a safe and sound manner.

I appreciate the willingness of Chair Matz and the NCUA board to tackle this tough issue and would like to offer my thoughts on the rule as it is proposed in the following areas:

1. Base assumptions and drivers of risks addressed in the proposed rule
2. Regulatory change is only one half of a comprehensive change in revitalizing the credit union capital structure
3. The decision to apply the new risked based capital (RBC) proposal to all credit unions over $50 million
4. Implementation timeline of the RBC proposal
5. Unintended consequences – examiner actions

Base assumptions and drivers of risks addressed in the proposed rule

I have attended multiple sessions about the RBC proposal with various staff and board members of the NCUA. In all the sessions the same three Congressional mandates were shared as the drivers for this proposal:

1. The RBC rule be comparable to other financial institutions (per section 1831o)
2. The RBC rule take into account that credit unions are not-for-profit cooperatives that don't issue capital stock, must rely on retained earnings to build net worth and have boards of directors that consist primarily of volunteers.
3. The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection.

I would like to share some observations of mine as I have worked through understanding both the purpose and the mechanics of the proposed rule

Comparability to other financial institutions

I think the proposed rule works diligently to create a comparable risk-based evaluation. It also avoids some of the complexities required of other charters due to their wider array of products and services and capital sources available to these other charters.

Not-for-profit cooperative differences

I feel that the NCUA hasn't fully taken into account the unique nature of the not-for-profit cooperative structure. To create regulations that increase capital requirements for an industry that already has the highest capital requirements, and only one avenue to increase capital (earnings) doesn't meet the mandate set down by Congress.

Recommendation – The NCUA take into account that – with a legislated minimum for a well-capitalized credit union significantly higher than other financial charters, the credit union industry is sufficiently capitalized. Imposing additional requirements without giving the industry additional sources of capital will unnecessarily restrict credit union growth and success.

Material risks

The third Congressional directive appears to being used to address a very real concern of both regulators and credit union boards and management – the eventual rise in interest rates. I would agree that rising interest rates will be the next challenge the financial industry faces. Next month or three years from now, credit unions will need to be ready and structured to weather the pressure on deposit rates against slower to re-price assets.

Codifying a bias against rising rates in the risk based regulations will create problems for the entire industry in the future. As sure as rates will rise, they will also fall. When they do fall credit unions will be faced with making the right choices for their balance sheet against a regulation that will discourage those decisions.

Recommendation – The NCUA review the risk weightings in light of a declining rate environment to ensure that the RBC final rule is balanced in risk mitigation.

Adequately Capitalized versus all credit unions

The directive from Congress was an RBNW to protect against **adequately** capitalized credit unions from exposing the Fund to risk of loss. This is a key variance from the RBC rule as proposed. Congress made it very clear the NCUA was to devise an RBNW calculation to deal with less than well capitalized credit unions. In discussions with NCUA representatives it appears that the mandate has been translated into a requirement that the RBC proposal result in more capital being required than the 7.0%. I couldn't find any legislative directive in which this is the desired outcome of Congress. Natural person credit unions came through the Great Recession with lower losses overall and proportionally than the banking system. Based on actual outcomes it would seem the legislated 7.0% has accomplished the purpose of protecting the Share Insurance Fund.

Recommendation – the RBC rule be modified to only apply to credit unions that are less than well capitalized. That the RBC calculation be made for well capitalized credit unions, but that it be only used in the evaluation/determination of the CAMEL rating – Capital section.

Regulatory change is only one half of a comprehensive change in revitalizing the credit union capital structure

The RBC proposal only addresses one-half of the credit union industry's need for capital reform. Legislative reform is also needed to address the industry's capital structure:

- Minimum capital requirements should also be addressed through a legislative fix
- The credit union's limit to capital through only one source (earnings) also needs to be corrected legislatively giving credit union meaningful access to secondary capital through subordinated debt.

Recommendation – That the NCUA board members actively solicit Congress to invest the NCUA legislatively with the ability to set minimum capital in the same manner as other financial regulators and that credit unions be given access to secondary capital with the NCUA having a similar authority to establish the source and method of that access.

The decision to apply the new risked based capital (RBC) proposal to all credit unions over $50 million

In meetings with the NCUA it was shared that the NCUA determined that credit union balance sheet composition starts to change significantly around the $35 million mark. Using this information the NCUA determined that $50 million would be the designation of complex.

There are many asset size delineations for purposes of regulatory enforcement or the ability to conduct business, as there should be. Credit unions that don't engage in some activities based on their size shouldn't be burdened with the regulatory reporting needed to monitor those types of activities.

Section 1790d.(a).(1) states: "The purpose of this section is to resolve the problems of insured credit unions at the least possible long-term loss to the Fund.

The risk to the Fund for smaller credit unions is much less than the risk of loss for the failure of a large credit union. During the "Great Recession" the real losses to the Fund in terms of natural person credit unions were for larger credit unions that made big "bets" on real estate, business lending and third-party outsourced lending. These types of activities are seldom encountered below $100 - $150 million in assets.

When a smaller credit union encounters net worth issues the tools the NCUA has available in terms of mergers with larger institutions is much greater than dealing with a large credit union in a similar position.

As of 12/31/2013 there were 5,199 credit unions under $100 million of which 175 had capital less than 7.0%. Compared to 4,414 under $50 million; 156 with less than 7.0% capital. The 19 credit unions $50-$100 million with net worth challenges could easily be dealt with using the existing regulatory exam methods of dealing with risk through letters of understanding and agreement, documents of resolutions and findings. This would provide regulatory relief to the 766 credit unions $50-$100 million with sufficient legislatively mandated capital without significant risk to the Fund.

Recommendation - I would ask that the NCUA revisit the asset level delineation of "complex" for the purposes of RBC and consider the $100 - $150 million range.

Implementation timeline of the RBC proposal

Eighteen months to possibly significantly restructure a complex balance sheet in a credit union almost guarantees losses in the divesture of the assets needed to comply. These losses would be even more if this is being carried out in a rising rate environment.

Recommendation – That the implementation timeline be extended to three years with a requirement that credit unions affected by the rule have an asset restructure plan in place within twelve months of publication of the final rule in the Federal Register.

Unintended consequences – examiner actions

At present, credit unions are required to have at least 7.0% net worth to be well capitalized. From a regulatory standpoint the NCUA representatives have stated that, with the exception of NCUA board action downgrading a specific credit union one level of capitalization, the NCUA can't require any additional capital.

I can state definitively that some examinations result in documented direction to credit union boards and management to increase net worth beyond the regulatory requirement. In discussion with NCUA representatives the RBC proposal was advanced as the solution to this practice. However, the reality is that, even when the credit union exceeds both regulatory 7.0% and the RBC proposal of 10.5%, the documented requirement to increase net worth still exists. My concern is whether this practice will continue with the implementation of RBC in its final form.

Recommendation – With the implementation of RBC in its final form, there is a concentrated effort to eliminate the practice of exam staff to exceed legislative and regulatory net worth requirements.

Conclusion

I would like to reiterate that I support a risk-based approach to capital adequacy evaluation. I look forward to the discussion and analysis that will result from the comment process in shaping the final rule. I appreciate the opportunity to offer my input.

Respectfully,

Thomas E. Griffith
CEO