MARSHFIELD
MEDICAL CENTER
CREDIT UNION

May 27, 2014

Gerald Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: Prompt Corrective Action-Risk Based Capital proposal

Dear Mr. Poliquin:

Thank you for the opportunity to comment on the Risk Based Capital proposal that is on the table for discussion. A little background on our credit union: Marshfield Medical Center Credit Union, based in Marshfield, Wisconsin, has approximately $60 million in assets and serves over 4,500 employees and family members of various health care facilities throughout the state, with the majority of our membership concentrated in the central Wisconsin area. We have a very healthy loan portfolio with very low delinquencies, but because of the makeup of our membership, we have more in member deposits than what we can issue in loans. As a result, we also have an investment portfolio that makes up approximately 30% of our balance sheet. I will note also that as of March 31st 2014 numbers, we would one of the approximately 10% of applicable credit unions that fall from the well capitalized category down to adequately capitalized.

I will begin by stating that I do not necessarily disagree with a need to review the current Prompt Corrective Action-Risk Based Capital standard. It is important for credit unions to maintain safe and sound operations to ensure that current and future members continue to reap the benefits that credit unions offer. It has also been over a decade since the passing of HR 1151 in the late 1990s that brought about the current PCA model, and many environmental and systematic factors have changed since that time. I am concerned, however, that the timing of this review coincides with concerns NCUA has expressed on a number of occasions about the presence of interest rate risk within credit union balance sheets as a result of the low rate environment we currently are in and the ongoing concern of the effect of rising rates.

As a result of reviewing the proposed rule, I feel compelled to comment on several issues I have with the proposal in its current format. In my humble opinion, the implementation of the proposed rule as currently drafted would have huge negative ramifications for the credit union industry as a whole and does not accurately account for true risks that are present. The industry as we know it today may cease to exist in any fashion in the near future if credit unions must abide strictly to the proposed components of this rule. Ultimately, the members would be the one paying the price if a number of credit unions felt it more appropriate to explore other options, such as mergers and/or bank conversions.

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Within the proposal itself, there are components that would directly affect the operations of our credit union and hurt our ability to serve our membership. There are also other aspects that do not directly impact our own credit union, but they would hurt the industry's ability to continue in its current form. I hope that with input received up to this point from credit unions, changes will be made to the current proposal going forward that will not cripple the ability of credit unions to fulfill the mission they set out over 100 years ago to do, which is to serve the needs of its membership.

§705.104(b)(2) Risk-Based Capital Numerator Deductions

To begin with the numerator portion of the ratio, I fail to understand why the NCUSIF deposit is to be removed from available risk-based capital in the proposal, as this amount is required by NCUA to be maintained in the NCUSIF based on 1% of the credit union's insured shares and is refundable in the event the credit union is to be liquidated. The annual adjustment to the NCUSIF deposit is capitalized as an asset rather than expensed because of its characteristics, as GAAP requires credit unions to account for the deposit in this matter. Subtracting the deposit from both the numerator and denominator, though, is not the proper way to adjust available capital as a result. If this deposit was to not be an available portion of capital, I believe GAAP would have required credit unions to expense the amount, which would have flowed through the income statement to net income and ultimately through to capital as an indirect reduction to available credit.

§705.104(c) Total Risk-Weighted Assets

Moving on to the denominator, I believe that the risk weights that have been assigned to various components of the risk based capital calculation are not justified and does not capture the risks identified in the proposal properly. For example, I am unsure how the risk weights for nondelinquent 1st mortgage real estate loans can be justified for the different classes of balance sheet concentrations. I hate to draw too many comparisons between the Basel III requirements that banks follow and the current proposal, but even Basel III calls for a 50% risk weight on all mortgage loans regardless of balance sheet concentration. How is a 1st mortgage real estate loan that is made at a credit union automatically twice as risky as a real estate loan made at the local community bank down the road strictly because of balance sheet concentration? Is concentration risk by itself truly that much of a risk? According to the proposal, "the concentration threshold amounts are generally based on the average percentage of assets held in the asset type". This statement holds no weight in making the argument that credit unions that hold higher concentrations than average are any more risky than credit unions at or below average levels. To arbitrarily make this statement with no support is dangerous. If the calculation is to include an adjustment for concentration risk, research should be conducted at a minimum to determine what amount of asset concentration must exist before concentration risk truly increases. Using a national average ignores geographical differences in the ways credit unions are run and the demands of its members, and ultimately a credit union could be penalized simply for being located in one area of the country over another.

Furthermore, a credit union with sound underwriting practices and a higher demand for 1st mortgage real estate loans is penalized more heavily than a credit union with a smaller 1st mortgage real estate portfolio and less stringent underwriting policies. To prove this point, the proposal has the risk-weight for a mortgage made by a credit union with a heavily concentrated real estate portfolio (excess of 35% of assets) the same as a delinquent real estate loan. It is no secret that during the recession, many borrowers became underwater on their mortgages as a result of the severe drop in property values and decided to stop payments on their mortgages to walk away and start anew. Can it be argued that one of these loans was as risky as a 1st mortgage loan with a 50% LTV made at a credit union that holds 35% of their assets in 1st mortgages? If one were to rely only on the risk-based capital calculation, the answer would be a resounding yes. It may be an extreme comparison, but one that, in my opinion, disproves the reliability of using this "one-size-fits-all" approach.

Also, a credit union with a real estate portfolio made up of adjustable rate mortgages is required to hold as much capital as a credit union with a portfolio consisting of all 30 year fixed rate mortgages. Even in the current risk based net worth calculation, only mortgages that are scheduled to mature, reprice, or be refinanced after 5 years are taken into account. How can a 3/1 ARM mortgage loan require no risk based capital to be held currently and potentially be assigned a 100% risk weight under the proposed system? There are a number of other examples that other commenters have given, but it again begs the question: how does the current proposal properly calculate risk present within a credit union balance sheet?

Another area I disagree with the proposal is in the investment weighting. To take a step back for a moment, the balance sheet of a credit union is determined primarily on the demand of its members. Credit unions consisting of members who have higher deposit needs than loan needs may have a balance sheet with both a loan portfolio and an investment portfolio. It is important to note that credit unions do not operate with the goal of building up a sizeable investment portfolio. They would much rather issue safe loans to its members if the demand is there. Ultimately, the size of a loan portfolio is based primarily on its membership's loan demand, among other factors. If credit unions cannot take member deposits and loan those funds out, they must do something to keep margins from compressing too much and hurting capital levels. The investment portfolio is the alternative. It would appear that the proposal is set on punishing those credit unions who rely on investment portfolios to allocate excess member deposits that cannot be issued in loans. I'm not sure how the proposed tiered risk weights properly captures interest rate risk, liquidity risk, and credit risk within this portfolio. For example, the proposal does not consider whether an instrument is a pass-through or a bullet instrument, so liquidity risk is not accounted for. The proposal does not consider the makeup of the credit union's deposits to determine if the credit union has matched liability durations to investment durations, so interest rate risk is not properly considered. Also, the underlying quality of the assets collateralizing the investment is not considered, so credit risk is not looked at. As referenced earlier, I am well aware that interest rate risk is one of the greatest concerns NCUA has going forward. I believe the proposed structure of the risk weightings is set up to attempt to primarily focus on IRR within the investment portfolio and takes little consideration into other risks, if any, that are present within an investment portfolio.

While the proposal makes this attempt to assess interest rate risk in a rising rate environment, like what we will see in the upcoming years, how are the weight classes justified during a time of falling rates? Rates have generally been falling over the past 30 years. How much in earnings has been lost over the years because credit unions were told to book assets with shorter durations in their loan and investment portfolios to combat the threat of the "rising rate environment" whenever that may come along? Down the road, once rates have peaked and began falling again, the credit union will be punished for buying longer duration investments, if available, based on the current structure of the proposal. According to the proposal, "the current risk-weights for investments relied on the results of 300 basis point interest rate 'shock tests' to corroborate the assigned risk-weights". Implied in this statement is an **up** 300 bps "shock" during a period when rates will most likely rise. I would find it hard to believe that the risk-weights are appropriately calculating IRR if you calculated a 300 bps down "shock" when rates are at their peak. If the credit union decides to book securities with shorter durations as to appease the risk based capital calculation, they are being punished with smaller yields, which lowers available equity and indirectly decreases the RBC calculation. Ultimately, I believe it is safe to say that no credit union has failed solely because of interest rate risk, and unless the credit union has structured their balance sheet with blatant disregard for rising rates (i.e. short term liabilities and long term assets), no credit union will fail because of this in the future. Interestingly enough, interest rate risk is at the forefront of this proposal, and I do not believe it is properly accounted for.

I also have taken issue with the weights assigned to Member Business Lending portfolios and investments in CUSOs, and while our credit union does not have a MBL portfolio or has invested in CUSOs, I feel it is still important to address this. Member Business Lending is an important driver of the economic recovery, and many credit unions have responsibly managed their MBL portfolio while helping out local businesses in the process, driving job creation and growing the economy. Requiring credit unions to maintain the proposed levels of capital based purely on balance sheet concentrations will discourage credit unions from growing their MBL services. While the proposal does address the current cap for Member Business Lending of 12.25 percent of total assets (with the exception of those credit unions who were granted MBL exceptions), this statement makes the assumption that going forward, this 12.25 percent cap will not change ever while the proposed risk based capital statute would be in effect. If credit unions are able to remove the hurdle of the asset cap limitation, they will face another hurdle with the high risk weighting assigned to higher concentrations of MBL. Again, as mentioned earlier with the real estate portfolio discussion, policies and underwriting are not taken into consideration regarding the actual risk present in any of these portfolios. A credit union with sound expertise in MBL is required to hold similar capital to a credit union with limited MBL knowledge, but I fail to see how the proposal would actually take this into consideration.

As mentioned earlier, our credit union has not invested in any CUSOs and does not have immediate plans to do so in the future. Other credit unions have successfully invested in CUSOs to help address an area or multiple areas of need in a cost-effective manner. Many times, the investment in CUSOs does not have dividends or calculate ROI like other investments, but they instead benefit the credit union's bottom line by reducing operating expenses on staff and overhead and offering higher levels of service to their members. While there may be CUSOs out there that are more risky and/or have caused losses in the past, I feel it is unfair to paint this broad brush over all CUSO investments and hope that the risk-weight is adjusted and reanalyzed.

I find that the arbitrary risk-weights assigned to various groupings are not sufficient at assessing potential risk present within the balance sheet. The concept of assessing risk within the balance sheet is not so simple as to utilize a simplified and standardized calculation to determine this. The use of this calculation will punish those credit unions that mitigate risk with sound policies and procedures and knowledgeable staff and turn a blind eye to credit unions who engage in risky practices and have a blatant disregard for the safety of its membership and the industry as a whole.

§ 702.104(d): Due Diligence Requirements for Asset-Backed Investments

There is a need for credit unions to understand the investments that it purchases and brings onto the balance sheet, and while I applaud the NCUA for addressing this need, I do not feel that the 1,250% risk weight assigned to any asset-backed investment that the credit union cannot demonstrate "a comprehensive understanding of the features" is appropriate. To be classified as well-capitalized by the 10.5% standard, a credit union would need to hold 131.25% of the asset in capital. Also, how will examiners enforce the concept that credit unions hold this "comprehensive understanding"? The proposal states that "the NCUSIF has experienced significant losses by credit unions that invested heavily in asset-backed investments without the board of directors or staff having sufficient expertise to understand and manage the risks". While it goes on to state how credit unions can accomplish this, it does not identify specifically *who* will be held responsible. Does each member of management need to be familiar, even if the investment does not fall under their area of expertise? Does each member of the board of directors need to be able to answer any and all questions related to the asset? What the proposal is saying is that if the credit union were to invest $100,000 in an asset that the examiner subjectively determines is not well understood by management and possibly the board of directors, the credit union must maintain $131,250 in capital as a result if they are well-capitalized per the calculation. Again, I believe that credit unions must be aware of what they are purchasing, but this entire section is vague, which could lead to subjective interpretations by examiners. If there is no way to make this an objective portion of the examination, I would recommend that this entire section be removed from the proposal.

§ 702.105: Individual Minimum Capital Requirements

The individual minimum capital requirement is a truly arbitrary and subjective measure within the risk based capital proposal that is unnecessary. While my underlying message throughout this letter is to assess risk where true risk is present, I feel that the individual minimum capital requirement takes the power away from a successfully run credit union and gives it to the regulator/examiner who is in charge of reviewing that specific credit union. How does NCUA guarantee that examiners do not abuse the power given to them with this section of the proposal? How will credit unions be ensured that this section is applied evenly and equally by each examiner? Credit unions with strong levels of capital who pose little threat to the NCUSIF may be required to maintain uncharted levels of capital to appease regulators, who may have little evidence to support the need to the excess reserves.

Section 702.105(c) provides that "appropriate minimum capital levels for an individual credit union cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria, and that the decision is necessarily based, in part, on a subjective judgment grounded in agency expertise". I would interpret this comment to mean that the use of this proposed calculation on its own is recognized by the NCUA board to not be a reasonable way to determine the true amount of risk present and subsequent levels of capital to support this, and that each credit union is to be analyzed on its own based on circumstances the calculation cannot factor in. This section of the proposal basically states that there is a floor as to the amount of capital that must be maintained by ALL credit unions to be "well-capitalized" regardless of the makeup of the balance sheet, but no cap to the required capital levels. There are instances where the credit union may be more risky, and therefore it's solely up to the determination of the examiner to come to this conclusion and assess an appropriate capital level as a result. The credit union could have the expertise, the understanding, and the appropriate capital levels to undertake such a risk, but the examiner could arbitrarily determine that this is all for naught and that the credit union should maintain more capital.

As the old adage goes, "you can't have your cake and eat it too". Either this calculation is not a feasible tool to be used because of the uniqueness of each credit union on its own or this calculation is to be used **only** as a tool by examiners to determine **IF** capital levels are not sufficient based on the risk appetite of the institution. Saying that every credit union is to have a minimum level of risk-based capital to the agency's specifications of risk with no regard for the individualism of each credit union is a slippery slope to walk along.

Section III: Effective Date

Based on the complexity in credit union balance sheets over $50 million, as identified in the proposal, it is hard to fathom the possibility of making the necessary changes to fall in line with whatever rule is finalized within 18 months. I believe it is necessary to increase the implementation period to a minimum of three years, although I would be more comfortable with an implementation period of five years. Banks have until 2019 to fully comply with Basel III requirements, which includes a gradual build up to the final proposal. Giving credit unions until the end of 2015 is another shortcoming of the proposal.

Conclusion

In the normal operation of a credit union, which asset in the following comparisons would you consider riskier?

- An unsecured $10,000 60 month personal loan or a $10,000 60 month second mortgage for property with a TLTV of 75%
- An indirect 84 month indirect loan with a 125% LTV ratio or a 7 year GNMA security
- A sound investment in a local CUSO or a 60 day delinquent unsecured credit card for a "D" credit borrower

For each comparison listed, the asset that I would consider the riskier of the two (unsecured personal loan, indirect loan, delinquent credit card) would have the **lower** risk weight. I ask that you begin by rethinking the risk-weights in the proposed rule to see if they truly and accurately reflect risks. I have listed a couple of examples, and I know others have listed numerous other examples, where this is not done. Please make the necessary changes to align the weights with the true risks.

Now that we're a few years removed from the financial crisis of the great recession, it's clear to see that credit unions made out fairly well based on all the circumstances and are ready to move forward in serving its membership. Passing this risk-based capital rule in its current state will be crippling for credit unions as they continue to move on from these times. The risk-weights that have been proposed are stricter than that of Basel III for the banking industry; yet, I think it's safe to say that many credit unions are in much better shape than many community banks. The idea has been introduced by others in the credit union world that it may be worth researching whether switching to a bank charter may be better for credit unions to serve its membership, which is more than unfortunate. It is the responsibility of the credit union to make decisions that will help serve its membership to the best of its ability, and if switching to a bank charter helps them do this, how can we blame them? Credit unions will not remain credit unions if it's not the best option for its membership.

At the end of the day, the **concept** of risk-based capital is needed to analyze the risk present in a credit union's balance sheet and to reduce the threat and exposure to the NCUSIF. The thing of it is, I don't feel that the risk based capital calculation in its present form does a sufficient job in properly accomplishing this task. Here's the bottom line: financial institutions, including credit unions, are in the business of taking risks every day. The success and failure of any financial institution lies in the managing of those risks. Credit unions with riskier assets should be required to hold higher levels of capital to accommodate those high levels of risk than credit unions with less risk. Fitting each credit union into a cookie cutter system that does not take into account important factors such as the quality of the credit union's underwriting standards or environmental factors that the credit union operates within is not doing the job. The concept of risk management in its entirety is much too complex to push all credit unions into a one-size-fits-all calculation method in order to accurately calculate risk present. If this is to pass in one way or another as a one-size-fits-all calculation, I would recommend in general that the risk-based capital calculation be used as a tool rather than an enforceable rule. Credit unions with low risk-based capital calculations may not necessarily be more of a risk to the NCUSIF than a credit union with a well-capitalized label, but it opens the door for examiners to ask questions and have constructive dialogue with credit union managers and boards.

The calculation indicates that NCUA is more knowledgeable in understanding where risk is present within each credit union as opposed to the institution's management team and board of directors. It is the job of examiners to regulate their subjects and ensure that safety and soundness of the industry is not jeopardized. It is the job of management and directors to run their credit union in such a way as to not put its members in harm's way. The proposed components of the rule implies that examiners are best served to take on both roles.

The changes proposed in this rule will change the mindsets of credit unions from putting members' needs first to managing to risk first and foremost, regardless of its members needs. An industry full of uncompetitive credit unions does not bode well for the industry or its membership. Please make the necessary changes to the proposal so that members are not the ones that ultimately suffer from this rule.

Again, I thank you for this opportunity to write on this topic. I hope that all the comment letters that have been submitted before and after me will be seriously considered by the NCUA board of directors in issuing a final version of this rule.

Sincerely,

David Murphy
Internal Controls Specialist
Marshfield Medical Center Credit Union