UI Employees of CREDIT UNION

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

RE: Comments on Proposed Rulemaking – Risk Based Capital

Dear Mr. Poliquin,

We respectfully submit the following comments representing our concerns about the National Credit Union Administration's (NCUA's) Proposed Rule on Risk Based Capital (RBC). With assets of $290 million, the University of Illinois Employees Credit Union (UIECU) serves 45,000 members from our field of membership of University Of Illinois students, faculty, staff, alumni, and surrounding communities. We support the concept of Risk Based Capital requirements in general in order to strengthen our industry, but feel that major modifications are necessary to ensure that the proposed rule doesn't have a significant negative impact on credit unions and the members they serve.

While we accept the importance of Risk Based Capital in theory, the currently proposed rule raises a number of serious concerns, including:

- Risk weights for specific categories of assets that lack disclosed justification and analysis, and are inconsistent with those that apply to similarly sized banks under BASEL III;
- Exclusion and/or limitation of specific Balance Sheet items in the calculation, such as NCUSIF deposits, Goodwill, and Allowance for Loan Loss balances;
- Provision for subjectively applied Individual Minimum Capital Requirements; and
- Inadequate time allowed for responsible implementation of Risk Based Capital.

Adopting the proposed rule in its current form creates a disparity in requirements between credit unions and similarly sized banks, resulting in considerable competitive disadvantages to credit unions. As a result, credit unions will be required to change strategies and make decisions that will be less beneficial to their overall strength and future success.

<u>Lack of Justification and Analysis of Risk Weights</u>

At UIECU, we have a number of concerns about the categorization and risk-weighting of the specific asset categories in the proposed RBC rule. These concerns are as follows:

- Risk weights for many asset classes are consistently higher than those for banks under BASEL III for the EXACT same assets. This discrepancy puts credit unions at a distinct competitive disadvantage.

Mailing Addresss: P.O. Box 500, Champaign, IL 61824-0500
phone: 217.278.7700 / toll free: 877.678.4328 / fax: 217.244.5789
www.uiecu.org / e-mail: info@uiecu.org

- Risk Weightings escalate at higher concentration levels of real estate loans, while concentration is not considered at all within the BASEL III system for banks.
- The proposed rule attempts to measure interest rate risk, but only considers the asset side of the balance sheet, a fundamental flaw in Asset Liability Management.
- There is no regard for collateral (loan to value or some government guarantees) or rate structure (fixed vs. variable) in risk weightings, when in fact these characteristics have a tremendous impact on credit risk and interest rate risk. In some cases, secured real estate loans have higher risk weightings than unsecured consumer loans.
- Risk weightings for assets such as CUSOs have higher than necessary capital requirements when in fact these assets do not have a history of causing material losses that would require additional capital reserves.
- Delinquent loans are defined differently under the proposed RBC rule than they are under BASEL III, causing credit unions to reserve capital for many more loans than banks. It is unclear why the same asset carries different risk depending on the owner of the asset. This disparity is even more perplexing considering that historically bank losses have been significantly higher than credit union losses.

<u>Exclusion/Limitation of Balance Sheet Items</u>

The Proposed RBC Rule specifically excludes NCUSIF balances and Goodwill and limits the Allowance for Loan Losses to 1.25% of risk assets. The purpose and reasoning behind the exclusion/limitation of these items is unclear and somewhat counter-productive.

- In the event of a loss or failure, the NCUSIF balance would be used first to directly offset the loss before the NCUSIF is affected, lending further support to including it in the RBC calculation.
- Eliminating goodwill as an asset removes one of the few advantages that enable healthy credit unions to merge with troubled credit unions. If these mergers become less viable due to negative RBC impacts, NCUA will be faced with more situations that will negatively impact the NCUSIF.
- There does not seem to be any logical support for including the value of the ALLL at anything other than what it actually is. The ALLL is designed to address the risk of loss inherent in the loan portfolio, so this entire balance would certainly be available to cover such losses, not just a reduced portion of it.

<u>Individual Minimum Capital Requirements</u>

Under section 702.105, NCUA has the latitude to impose additional higher capital requirements on a case-by-case basis. We do not support this provision in any form. It dilutes the objectivity of the RBC calculation, is too vague, and allows for entirely too much interpretation by individual examiners. Instead, we would suggest that this section is deleted in its entirety in favor of allowing subjective measurement of all risk areas to be addressed through effective use of the regular safety and soundness examination process.

<u>Inadequate Time for Implementation</u>

The proposal allows for an eighteen month implementation period once the RBC Rule is finalized and implemented. This time period is insufficient to allow for responsible implementation of such an important and impactful change. Many credit unions have strategic plans and initiatives already underway that often reach five years into the future. These plans and initiatives will need to be altered significantly in order to address the changing growth and earnings impacts from the new RBC Rule.

In comparison, under the most recent revision to the BASEL III system, banks will have nine years to fully implement the system. Considering the superior performance of the credit union industry over banks during the past five years of economic upheaval, there is no evidence to suggest that there is need for an accelerated implementation period.

While we understand and appreciate NCUA's attempt to limit risk and protect the National Credit Union Share Insurance Fund through a more robust measure of capital adequacy, we believe that the proposed rule in its current form would cause unjustified negative impacts on credit unions and their members. Having a more rigorous capital requirement than banks of similar size is inconsistent with the historical performance and loss history of these two groups.

We thank you for the opportunity to comment on the Risk Based Capital Proposed Rule. We are confident that by working together with credit unions, NCUA can develop a fairer, more appropriate Risk Based Capital approach that will build a stronger credit union system.

Please do not hesitate to contact me if you have any questions at (217) 278-7701.

Respectfully,

E.J. Donaghey
President/CEO
University of Illinois Employees Credit Union