May 20, 2014

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,

The University of Illinois Employees Credit Union (UIECU) appreciates the opportunity to comment on the National Credit Union Administration's (NCUA's) Proposed Rule on Risk Based Capital (RBC). With assets of $290 million, we serve 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 and appreciate NCUA's attempt to develop standards to assess risk in each credit union's balance sheet, but feel that in its current form, the proposed rule is significantly detrimental to credit unions and the members they serve.

While we understand and agree with the premise 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.

We believe that 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.

Lack of Justification and Analysis of Risk Weights

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 include the treatment of Federal Reserve Cash, Investments, CUSOs, Real Estate loans, and delinquent loans. These concerns are as follows:

- Federal Reserve Cash – Under the proposed rule, cash on deposit at the Federal Reserve is risk weighted at 20%. This weighting is especially confusing considering that the Federal Reserve is one of two allowed emergency liquidity sources, supporting the idea that deposits at the Federal Reserve incur very little risk. We would suggest that these deposits are instead risk-weighted at 0%, consistent with the BASEL III system for similarly sized banks.

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- Investments – In contrast to the BASEL III system for banks, NCUA's attempt to address investment risk is inconsistent and punitive. The proposed RBC rule assigns risk weighting solely on the basis of the Weighted Average Life (WAL) of the investment, completely ignoring collateral types and government guarantees, both specific and implied.

  While U.S. Government securities such as Treasuries are risk weighted at 0%, Fannie Mae and Freddie Mac securities are classified according to WAL. Recent history and performance has shown that these securities with no credit risk should be classified as 0% as well. Consider that a 30 Year Treasury carries a risk weight of 0%, while a FNMA security with a WAL of 5 years carries a risk weighting of 150%. This is directly opposite to the interest rate risk measurement NCUA is attempting to include. Discrepancies such as these lead to poor decision-making from an ALM perspective.

  Furthermore, the application of risk weights purely on the basis of Weighted Average Life is inconsistent with BASEL III. The same investment with a WAL of 5 – 10 years is weighted at 150% for credit unions, yet only 20% for banks. Even worse, the risk-weighting for investments with a WAL of more than ten years is 200% versus 20% for banks. The treatment of investments is extremely perplexing considering that these are exactly the SAME investments that, according to NCUA, have different amounts of risk depending on who owns them – a bank or a credit union.

  The proposed rule is also inconsistent with its own risk weights with regard to collateral. A credit union initiated 30 year fixed rate first mortgage loan carries a risk weighting of 50%, while a FNMA security with virtually the same collateral plus the additional benefits of an implied government guarantee and a high degree of liquidity carries a risk weighting of 150%. There seems to be no logical justification for this disparity.

  The impact of these inconsistent weightings limits the investment choices of credit unions and therefore decreases our opportunities to increase earnings and improve capital.

- CUSOs – Credit unions depend on CUSOs for many reasons, including consolidating functions in order to decrease operating costs. There is no apparent rationale for supporting a risk-weighting of 250% as CUSOs do not have a history of causing material losses that would require additional capital reserves. We would support a risk-weighting for CUSOs at 100%. Anything higher would hinder collaboration between credit unions, one of the remarkable characteristics that distinguish credit unions from banks and contribute to our long term success as an industry.

- Real Estate Loans – Risk-weightings for real estate loans are inconsistent with other assets in the proposed RBC rule, as well as for the BASEL III system. The proposed rule completely ignores important loan characteristics such as term/maturity, pricing (fixed vs. variable), and loan to value percentages. Instead, NCUA has chosen to apply the same risk weighting for all residential real estate loans with the only adjustment at higher concentration levels. It is not readily apparent why concentration risk is addressed here when it is not included in BASEL III or elsewhere in the proposed rule.

  In addition, second mortgage loans, such as home equity loans, carry a higher risk weighting than the same loans for banks, depending on concentration. It is important to note that at some concentration levels, these loans carry a higher risk weighting than unsecured consumer loans.

Finally, residential mortgages guaranteed by FHA or VA are risk-weighted at 20% under the proposed rule. We believe that these mortgages should have a 0% risk weight, recognizing the value of the government guarantee and consistent with the BASEL III system.

The proposed rule would cause us to limit the number and amount of real estate loans we can offer to our members. With competitive rates, low fees, and extremely low historical losses, this change would directly affect our members in a negative way.

- Delinquent Loans – The proposed RBC rule defines delinquent loans as 60 days past due, while the BASEL III system defines loans as delinquent after 90 days, causing credit unions to reserve capital for many more loans. Once again, 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.

Finally, attempting to address Interest Rate Risk in the risk-weighting of assets only and ignoring the Liability side of the Balance Sheet is a failure of one of the most fundamental principles of Asset Liability Management.

Exclusion/Limitation of Balance Sheet Items

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.

While the NCUSIF deposit is excluded in both the numerator and the denominator of the RBC calculation, we would argue that it should be *included* in both. There are no indicators that this balance should be expensed at any time in the foreseeable future, so the asset is intact by GAAP standards. In addition, there is a reasonable expectation that this balance would be refunded in several specific instances such as transition to private share insurance, conversion to a bank or savings institution, or voluntary liquidation. This factor further reinforces the validity of the value of the asset. Finally, by definition, capital includes amounts available to cover losses. 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.

The exclusion of goodwill from the numerator of the calculation is also cause for concern. 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. This unintended consequence affects not only the credit unions involved, but all credit unions through payment of additional premiums.

The limitation on ALLL to 1.25% of risk assets is perplexing. 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 portion of it.

Individual Minimum Capital Requirements

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.

Inadequate Time for Implementation

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. For UIECU, any or all of the following changes could be necessary to improve our capital position: divesting assets rather than growing, avoiding mergers, keeping less cash on deposit, changing balance sheet structure in favor of preferable risk-weighted assets, changing business partners to get away from CUSOs, limiting loan growth, and changing fee structure to recover lost income. These decisions are not in the best interests of our credit union in the long term, but could be necessary as dictated by the proposed RBC rule.

Eighteen months is far too short a time frame to expect these changes to be fully in place. In comparison, under the most recent revision to the BASEL III system, banks will have had nine years to fully implement the system. Taking 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.

At UIECU, 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. However, we believe that the proposed rule in its current form would cause a wide-spread negative impact on credit unions and our members well into the future. These unintended consequences would hinder the growth and success of credit unions in direct opposition to NCUA's purpose of promoting safety and soundness. 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.

We thank you for the opportunity to comment on the Risk Based Capital Proposed Rule. Please do not hesitate to contact me if you have any questions at (217) 278-7708 or jpeyton@uiecu.org.

Sincerely,

Jennifer Peyton
Executive Vice President/Chief Financial Officer