P.O. Box 129
Albuquerque, NM 87103
505.342.8888
1.888.342.USNM TOLL FREE
www.usnmfcu.org

U.S. New Mexico
FEDERAL CREDIT UNION

5/5/2014

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

Mr. Poliquin,

Change can be difficult; however, it is often necessary to adapt, innovate and survive in a changing environment. Nowhere is the need for change more prevalent than in our industry where new threats arise daily and consistently challenge us to improve how we do business. Whereas we agree that the NCUA's risk-based net worth requirement is in need of change, we foresee significant problems and unintended consequences for both the NCUA and the credit union industry if the proposed risk-based capital rule is implemented in its current form. As drafted, the proposed risk-based capital rule does not allow credit unions to adapt to the changing economic environment in a manner that is best for the consumer, the U.S. workforce, and for the financial stability of the credit union industry. The proposed rule actually magnifies the disadvantages credit unions already carry in a very competitive environment.

While we appreciate the emphasis NCUA has put on forming an improved risk-based capital rule, a better approach for the industry as a whole would be to adopt a rule more in line with the proposed Basel III requirements for banks. This approach would lend additional credibility to the NCUA as a regulatory body, provide consistency within the industry in terms of capital evaluation, and as a result allow credit unions to compete on a more level playing field. As the regulatory body of credit unions, NCUA is perhaps the most visible face of, and advocate for, the credit union movement. As such, NCUA should work to maximize the opportunities for credit unions and to further the credit union philosophy. Unfortunately, the proposed rule does more to inhibit the important role of credit unions in the marketplace than it does to preserve it.

We recognize that there will never be a perfect regulatory solution that will benefit all credit unions equally. That is simply an inherent flaw of a "one size fits all" approach to regulation, but a flaw we recognize as necessary to facilitate regulating an industry where risk is so prevalent. It is not lost on us that our credit union's capital position remains "well-capitalized" under the proposed rule. However, not all credit unions fare the same. The adverse effect of the proposed rule on other credit unions is a major concern to us because we believe that the consumer/member is best served by having a choice of which credit union(s) to join. In addition, every credit union that may close its doors as a result of the proposed rule, or every potential new credit union that may face unsurmountable barriers to entry, would constitute a loss of choice to the consumer/member and a loss of sustainable jobs at a time when robust job growth is the most vital missing element for the nation's economic recovery. In addition, what may not appear to be significant to us today may become very significant to us in the future and we must plan appropriately for such possibilities. With that said, there are certain elements of the proposed rule that are unnecessary, unfair to ALL credit unions, and will generally hinder growth and opportunity for the credit union industry. Although our opinion is that the entire proposed rule should be revisited and revised with ALL credit unions in mind, the following five elements of the proposed rule are of significant concern to our credit union individually and should be properly addressed by NCUA in any subsequent revisions to the rule:

1) 250% risk-weight for CUSO investments
2) Investment risk-weights
3) Non-Delinquent First Mortgage Real Estate loan risk-weights
4) Individual Minimum Capital requirements
5) Abbreviated implementation period

250% risk-weight for CUSOs

CUSOs provide valuable services for their credit union clients and also provide a valuable source of income for their investor credit unions. NCUA currently caps the aggregate investment in CUSOs by any credit union at no more than 1% of that credit union's assets. As an industry, the aggregate investment in CUSOs is less than one-quarter of that limitation. The proposed rule sets a risk-weight of 250 percent for investments in CUSOs. However, NCUA provides little to no rationale for why a 250 percent risk-weight is appropriate. While an investment in a CUSO is an unsecured equity investment and subject to losses, this would indicate a more appropriate risk-weighting of 100% in the event the equity in the CUSO was completely lost. What is the rationale behind the additional 150 percent requirement?

A 250 percent risk-weighting is unrealistic and unworkable will deter the formation and further investment in CUSOs. Without a substantive rationale behind why a CUSO investment merits such high risk-weighting, the proposed rule appears arbitrary and aimed at limiting the use of CUSOs. The result is an additional barrier to credit unions looking to expand their services and/or find alternate sources of income. As a credit union that wholly owns a CUSO and has investments in other CUSOs, this rule will cause us to reconsider our CUSO investments in the future. U.S. New Mexico recommends the risk-weight for CUSO investments be reduced to a 100 percent risk-weighting consistent with the actual risk of making such an investment.

Investment risk-weights

While all credit unions would ideally prefer to lend as much of their deposits as possible, in many cases this is not always feasible or the best option in terms of risk. Thus, investments play a key role in a credit union's balance sheet management, interest rate risk management, and overall earnings profile. The proposed investment risk-weights have the effect of penalizing short- and medium-term investments. There are no comparable capital requirements for loans of similar terms, indicating a bias toward lending in the capital requirements. In essence, the rule appears to be attempting to manage the interest rate risk of the investment portfolios of credit unions through regulation. Credit unions are already under close scrutiny for managing the interest rate risk of their investment portfolios from both the NCUA examination and supervision processes. The proposed additional layer of intervention is overly burdensome and unnecessary.

It is also unclear why credit unions who invest in shorter-term securities, those in the 1 to 5 year maturity range, should be subject to higher capital requirements in relation to those investments than are banks. This disparate treatment regarding investments does not protect the consumer or the wellbeing of the credit union industry and is unnecessary. The Basel III requirements for small banks place a broad risk weighting to 20 percent on all investments regardless of term. Again, the proposed rule by NCUA provides additional and unnecessary competitive advantage to banks both in terms of how they structure their balance sheets and their potential earnings levels. We recognize that longer-term investments are inherently more risky than shorter-term investments. However, the proposed risk-weights are not commensurate with the overall level of risk each grouping is assigned.

U.S. New Mexico recommends that the risk weights for short-to medium-term investments, those in the 1 to 5 year range, be assigned a weighting of 20 percent. Longer-term investments of 5 to 10 year terms and longer than 10 year terms should be assigned higher risk weights commensurate with the risk undertaken, such as 100 percent and 200 percent, respectively. A risk-weighting structure of this type would more accurately capture the actual risk of the investment by term and not unnecessarily penalize credit unions for investing out longer than 12 months.

Non-Delinquent First Mortgage Real Estate loan risk-weights

The methodology the proposed rule utilizes to structure capital requirements for non-delinquent first mortgages indicates an unfounded position that a larger concentration of these types of loans is inherently too risky. Carefully underwritten first mortgages are the backbone of the nation's middle class and these loans are a core business element of the credit union industry, which was formed in whole to provide exactly these types of loans as part of its intended purpose of helping the credit structure of the United States. While concentration risk is a recognized and managed risk on credit union balance sheets, concentration risk in and of itself is not inherently risky. Concentration risk only magnifies other risks already present on the balance sheet and therefore should be looked at differently from other types of risks that are inherent to credit union activities (like interest rate risk, for example).

The proposed rule does not take into account any factors within a credit union's real estate portfolio that would indicate these loans are more or less likely to default or that losses would be more severe should the loans default. A concentration of high-LTV loans has a greater propensity for large losses than a high concentration of low-LTV loans. But concentration does not create the risk. The risk is caused by the LTV. Without including root cause factors like this and merely focusing on concentration alone, the capital requirements as drafted are overly broad and do not adequately capture the true risk of these loans.

The proposed rule weights concentrations of non-delinquent first mortgage loans under 25 percent of a credit union's assets at a 50 percent risk-weight. That risk-weight moves to 75 percent for concentrations above 25 percent but below 35 percent of a credit union's assets and it moves to 100 percent for loans that are in excess of 35 percent of a credit union's assets. There is no evidence that a higher concentration of these type of loans leads to a greater probability of loss, as the increasing risk-weights would indicate. The Basel III system for small banks equally weights all non-delinquent first mortgage loans at 50 percent risk-weighting. Again, the proposed rule saddles credit unions with another disadvantage to banks that compete in the same market for the same loans.

The proposed risk weights for non-delinquent first mortgage loans are too high, they do not capture the true risk of these loans, they penalize credit unions for concentrations that are not inherently risky, and they create a competitive disadvantage for credit unions relative to banks. U.S. New Mexico recommends NCUA revisit these risk-weights by concentration and identify a structure more closely in line with the Basel III requirements.

Individual Minimum Capital requirements

Perhaps one of the most significant changes to the capital requirement rule is the introduction of individual minimum capital requirements. Per the proposed rule §703.105, NCUA may require an individual credit union to maintain a higher risk-based capital amount in any case where NCUA deems it appropriate. While there are real questions concerning the legal authority of NCUA to implement this part of the rule, the more concerning aspect here is the introduction of subjectivity into the application of the rule. Allowing for individual capital requirements to be required of individual credit unions based on the subjective opinion of an examiner completely undermines the purpose of the rule. If the proposed rule is designed to identify and control for the many risks that credit unions face, then why would additional and subjective regulatory impediments be necessary, unless the rule itself is inadequate? If there is a chance that a credit union has adequate capital as defined by the proposed rule, yet is deemed to have insufficient capital as determined by an individual examiner, then the problem lies in the rule and not with the credit union and the rule should be revisited.

The proposed individual capital requirements introduce uncertainty and subjectivity into a system that should be free from both. This component of the proposed rule ignores the fact that the credit union industry survived and functioned properly during the economic meltdown and by keeping the consumer loan market functioning even as other industries were seeking TARP funds, constricting or ceasing consumer lending, raising prices, and failing to assist and protect our nation's middle class. U.S. New Mexico recommends that any reference to individual capital requirements be completely dropped from the proposed rule and that all credit unions should be measured by the same standard.

Abbreviated implementation period

Upon passage of the final rule NCUA has established an 18-month window for credit unions to make adjustments in preparation for complying with the rule. Given the broad changes that are being made in the rule, the significant impact these changes will have on many credit unions, and the limited resources credit unions have to raise necessary capital, the 18 month window is much too abbreviated and should be extended.

The primary issue here is not that credit unions are unable or unwilling to comply within 18 months. Rather, the issue is the unreasonable burden this shortened timeframe places on credit unions that may have to make significant adjustments to their capital. Because credit unions do not have access to supplemental capital, all adjustments to capital will have to come through retained earnings. The retention of additional income to significantly raise capital ratios requires more than 18 months. The significant time element involved in this endeavor is inescapable, and it is likely that many credit unions will have to redirect earnings to this endeavor by not implementing strategic projects that have been carefully planned and are already underway. It is unfair and unreasonable to expect credit unions to react this quickly to such a large regulatory change.

Upon passage of the final Basel III rule, small banks were given 3 years to comply with the requirements. What is the justification by NCUA for giving credit unions half that amount of time to comply with a rule that is more capital intensive than other similar rules and that will take credit unions at least twice as long to raise the necessary capital? Again, the clearly disparate implementation of this proposed rule for this industry creates another competitive disadvantage for credit unions in relation to banks. Credit union members will suffer for no valid reason. It is our position that the final rule should allow for an implementation period of not less than three years and preferably five.

Conclusion

U.S. New Mexico recognizes the importance of change. We also recognize that carefully designed new capital requirements are long overdue and will ultimately have a beneficial effect on the industry as a whole. However, U.S. New Mexico is of the opinion that the proposed risk-based capital rule is not workable in its present form, insufficient, often overreaching, and clearly creates additional unnecessary disadvantages for credit unions and their members. As the regulator of all credit unions and as the primary advocate for strengthening the credit union movement to aid consumers, NCUA should strive to create an environment where credit unions can intelligently adapt to change within acceptable risk parameters, compete fairly in the marketplace and not be subjected to unnecessary regulations carrying unintended consequences. U.S. New Mexico respectfully recommends that the proposed rule be revisited and revised with these and all other credit union comments in mind.

Sincerely,

Marsha Majors

Marsha Majors
President/CEO
U.S. New Mexico Federal Credit Union