From:	Bill Birnie
To:	_Regulatory Comments
Subject:	Bill Birnie - Comments on Proposed Rule: PCA - Risk-based Capital
Date:	Tuesday, May 27, 2014 8:10:52 PM

May 27, 2014

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

Re: Comments on Proposed Rule – Risk Based Capital – RIN: 3133-AD77

Mr. Poliquin,

I am writing to comment on behalf of Eagle Community Credit Union on the proposed Risk-Based Capital rule. At Year-End 2013 Eagle Community Credit Union had 19,000 Members and $205,023,000 in Assets. We appreciate the opportunity to provide these comments on the proposed rule.

As of Year-End 2013 Eagle Community Credit Union's Net Worth/Capital Ratios under the current Prompt Corrective Action (PCA) system, the proposed Risk-Based Capital (RBC) system and Basel III for Small Banks (Basel III) system as determined by the calculator provided by the Credit Union National Association were as follows:

Current System

Net Worth Ratio: 8.2% Well Capitalized
Risk-Based Net Worth Ratio: 6.4% Well Capitalized

Proposed Risk-Based Capital System

Risk-Based Capital Ratio: 9.9% Adequately Capitalized

Basel III System for Small Banks

Risk-Based Capital Ratio: 13.2% Well Capitalized

Key Issues of Concern with the Proposed Risk-Based Capital Rule

- Impact of increased capital expectations on a Credit Union's ability to grow and generate earnings
- Perception of a higher level of risk at Credit Unions as opposed to small banks
- Arbitrary risk-weighting that far exceeds those imposed by banking regulators
- Excessive and unsubstantiated risk-weighting for investments in CUSOs
- Authority to establish an Increased Minimum Capital Requirement on individual Credit Unions
- Lack of consideration for risk mitigating efforts taken by individual Credit Unions
- Unreasonable transition time frame for Credit Unions adversely impacted by the

proposed rule

Potential Impact on Growth and Earnings

During the three-year period of 2007 – 2009 the Eagle Community Credit Union (ECCU) sustained nearly $9M in losses and PCA Net Worth fell to a low of 6.44%. From Year-End 2009 to Year-End 2013 the Credit Union recorded 16 consecutive months of positive earnings, nearly $35M in Asset growth and 173bp in PCA Capital growth. Our focus has been on enhancing Member value, process efficiencies, operating expense control and the intelligent investment in infrastructure.

As noted on the previous page, as of December 31, 2013 ECCU was classified as Well Capitalized under PCA with a Net Worth Ratio of 8.17%. Yet, under the proposed RBC rule, our Credit Union falls to only Adequately Capitalized with a RBC Capital Ratio of 9.90% - 60bp below the threshold to be considered Well Capitalized.

Some options available to the Credit Union to attain compliance with the proposed RBC Rule include:

Restructure the Balance Sheet: The Credit Union could shorten the weighted average life of earning assets through the divesture of longer term assets via the open or secondary markets thus reducing the denominator of the RBC calculation. However, it should be noted that in the current interest rate environment, the divesture of these longer termed assets and subsequent re-investment of funds into assets with shorter terms, and naturally lower yields, will adversely impact overall earnings – and the ability to grow capital.

Enhance Net Income via Expense Control: Throughout the past several years most Credit Unions, and this is especially true of ECCU, undertook significant efforts to reduce expenses. Some of the more dramatic actions included lay-offs of personnel and the closure of branches. I believe that most Credit Union professionals will attest to the fact that we do not have many opportunities to cut expenses further without a material disruption to the provision of Member services. I believe that now is the time to intelligently invest in our future. However, the need to generate capital may force us to forgo opportunities to leverage technologies that would generate efficiencies and enhance Member value. We may need to reconsider our desire to focus lending efforts on Members with less than stellar credit as these loans will require an increase to the Allowance for Loan Losses via the Provision for Loan Loss Expense. We will have to keep the need for capital accumulation in mind when we consider the offering of new products, services and conveniences to our Membership. These are just three examples and none of them are in the best interest of our Members or the long-term viability of their Credit Union.

Grow Loan Income: Believe me, we are trying!

Increase Non-Interest Income: In comparison to other Credit Unions we do not have a very competitive fee structure. While I suspect that some elasticity exists in regards to fees, I also believe that there is a point where that elasticity snaps. Once you've lost Members as a result of high fees, getting them back is nearly impossible. We continue to seek out avenues to generate non-interest income from other sources – such as interchange, shared branching, etc. – but regulatory and legislative initiatives place these income sources in danger.

Employ Interest Rate Risk Mitigate Tools: Attaining long-term, fixed rate borrowing would, to some degree, mitigate interest rate risk without extending the weighted average life of assets. But it would also increase Total Assets and thus adversely impact Net Worth under PCA. Being under $250M in assets, the Credit Union is prohibited by the recent rule on derivatives from engaging in hedging vehicles such as simple interest rate swaps without applying for and being granted an exception – which we are exploring. But ultimately, the RBC Rule as proposed offers no relief to organizations that have effectively employed risk mitigation tools and strategies.

Risk Perception of Credit Unions compared to small banks

I concur that the establishment of RBC requirements for Credit Unions is prudent. However, I also believe that those requirements should not be more restrictive and punitive than those in place for banks. It is my perception that by the very nature of their motivation as not-for-profit financial cooperatives, Credit Unions are more conservative than banks. Clearly the NCUA does not share my perspective as demonstrated by the variance between RBC Ratios generated by the proposed rule and Basel III. As shown above, under the proposed rule, ECCU's RBC Ratio is 9.90% - Adequately Capitalized. Yet, under Basel III our RBC Ratio is 13.20% - Well Capitalized. A variance of 330bp! I fail to understand how such a variance is justified. The proposed rule doesn't even come close to providing parity and places Credit Unions at a significant competitive disadvantage.

Risk-Weighting of Assets

The biggest flaw in the proposed rule is the extent to which the NCUA's arbitrary risk weightings far exceed those imposed by banking regulators on banks via Basel III. The safety and soundness track record of Credit Unions does not justify the punitive impact of these excessively restrictive risk weightings.

Investments in CUSOs

I do not believe that all CUSOs represent significantly elevated levels of risk. The proposed risk weighting of 250% on investments in CUSOs is akin to using a shotgun when a rifle would be more appropriate. Is it NCUA's contention that an investment in COOP Financial Services or CU Direct carries the same level of risk as an investment in a brand new CUSO? CUSOs provide important services to Credit Unions in an efficient and cost effective manner. Penalizing Credit Unions for investments in CUSOs will lead to the curtailment of such investments. Thus stifling innovation, all but eliminating the creation of new CUSOs, reducing competition among CUSOs, and increasing the costs of the products and services CUSOs provide.

Increased Minimum Capital Requirement

I recognize that rare situations may exist where a particular asset represents a level of risk that is greater than the assigned risk weighting. However, I do not concur that this should be addressed via a global increase in the total minimum capital requirement. It is my perception that the global nature of the proposal excessively elevates the subjective nature of the Increased Minimum Capital Requirement. I believe it would be far more focused and appropriate that the perceived elevated risk associated with a particular asset be addressed by adjusting the risk weight for that specific asset. In addition, the potentially subjective nature of the proposed Increased Minimum Capital Requirement must be recognized. Appropriate oversight of such impositions and an independent appeals process should be incorporated in the final rule.

Unreasonable Transition Time Frame

The proposed implementation period of 12 to 18 months is simply inadequate. I fear that Credit Unions – such as ECCU – who fall from their current "Well Capitalized" status under PCA will be forced to make a choice between effecting dramatic Balance Sheet changes and realizing the potential for principal losses and reduced future income or failing to attain a RBC "Well Capitalized" status by the conclusion of the implementation period and incurring the wrath and scrutiny of an elevated examination process. Banks were given 5 to 7 years for the implementation of Basel III – why would Credit Unions only be afforded 20% to 25% of that timeframe?

Conclusion

As you work toward the finalization of this rule, I ask that you consider the following:

- The adverse impact the proposed rule will have on Credit Unions' ability to grow and enhance Member value.

- The development of a process that recognizes the effective implementation of risk mitigation tools and strategies.

- That risk weighting of assets should be fully justified and no more onerous than those imposed on banks via Basel III.

- Recognition that all CUSOs are not alike and develop a process that looks to numerous factors (such as Total Capitalization, the diversification of the sources of that capital, and the financial posture of the CUSO) to assign commensurate risk weightings.

- Eliminate the global, subjective and potentially unbridled ability to impose Increased Minimum Capital Requirement altogether. I believe it would be palpable to replace the currently proposed Increased Minimum Capital Requirement with a process that recognizes elevated risk within a particular asset and increases the risk weighting for that specific asset as long as this process is subject to appropriate supervisory oversight and provision of an independent appeal avenue.

- Change the definition of a delinquent loan from the proposed 60 days to 90 days to attain parity with Basel III and/or only apply risk weighting to the net of Delinquent loans and the Allowance for Loan Loss account.

- Extend the implementation period to 5 years to allow Credit Unions the time to carefully and methodically attain compliance.

Thank you for the opportunity to comment on this important proposed rule regarding Risk-Based Capital.

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