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

Dear Mr. Poliquin,

CliftonLarsonAllen, LLP (CLA) appreciates this opportunity to comment on the National Credit Union Administration's (NCUA's) proposed regulation for Prompt Corrective Action – Risk-Based Capital.

CLA is one of the nations' Top-10 largest public accounting and consulting firms. In addition, **CLA audits more credit unions than any other firm in the United States** (per the National Market Share Ranking published by Callahan & Associates as of December 31, 2013).

CLA fully supports the concept and requirement for credit unions to be subject to a risk-based capital system as long as it aligns with, and provides a direct link between, the actual risk exposure posed by the underlying credit union assets covered by the share insurance fund and the capital requirements for the credit union industry. In our opinion, the current NCUA proposal does not mirror the risks associated with the credit union industry based on its past performance, including the period of time during and after the recent recession. In addition, certain requirements for credit unions and authorities granted to the NCUA by this proposal appear overly restrictive, and may significantly affect credit unions' ability to plan and manage their capital to ensure they meet the well-capitalized definition under this proposed standard. Lastly, the proposed ratings could affect many credit unions' future strategic plans, and reduce their ability to provide the same historic level of service to their members.

CLA believes this proposed regulation (or any future revised versions) would likely receive a more positive reception from the credit union industry if the NCUA were to justify the need for these requirements by demonstrating how implementing these risk-weightings would have mitigated the corporate credit union collapse or prevented recent credit union failures. As many respondents and industry economists have noted, there is some question as to whether this proposed regulation, as it is currently written, would have had any impact during the recent recession.

DEFINITION OF A COMPLEX CREDIT UNION

The NCUA's proposed regulation was published February 27, 2014 (79 Fed Reg 11184), and seeks to establish new, more robust risk-based capital (RBC) standards for all credit unions that meet the definition of "complex", which according to the proposal includes all credit unions that are federally insured and exceed $50 million in total assets.

This definition for complex credit unions subject to the proposed RBC regulation is somewhat arbitrary, as it does not take into consideration the types of investments, product offerings or other operations that may result in an increased risk to the share insurance fund. The obvious result of this type of cut-off provision would be that many relatively low-risk, smaller credit unions that have very "non-complex" operations would be subject to the more stringent and costly requirements under the proposed RBC regulation strictly based on their asset size. Defining a credit union as complex purely based on its assets size may be misleading, as there are credit unions with assets in excess of $100 million that CLA would consider less complex than some credit unions with assets less than $50 million.

We encourage NCUA to reconsider their proposed definition of a complex credit union. Within the banking industry, many of the smaller community banks feel they are being subjected to more stringent rules and regulations because of the most recent financial crisis, and that this crisis was caused and worsened by the actions of the large banks, not the small ones. We would recommend that the NCUA review the credit unions that caused losses to or problems within the credit union system during the most recent financial crisis, and utilize this data for defining what factors should be considered for defining a complex credit union subject to their proposed RBC regulation.

Perhaps the threshold for which credit unions are to be subject to the proposed RBC regulation could be revised and additional factors indicative of higher levels of risk should be considered. Factors such as excessive concentrations for certain asset types, new product offerings for which the credit union may lack the expertise necessary to establish adequate underwriting or due diligence controls, or trends indicative of declining performance; as opposed to using a purely asset size threshold as the sole criteria for this determination.

RISK WEIGHTINGS

The NCUA's proposed RBC regulation shares many similarities with the Federal Deposit Insurance Corporation's (FDIC's) Basel III interim final rule that revised the risk-based and leverage capital requirements for FDIC-supervised institutions. However, there are a few key differences that do not seem to reflect the historical loss rates experienced within the credit union industry, which tend to be historically less than those of their banking counterparts.

Allowance for Loan and Lease Losses (ALLL)

Under the NCUA's proposed regulation, the ALLL will be limited to 1.25% of risk assets in the computation of RBC. Under current accounting rules, this limitation may not have much impact as many credit unions have ALLL balances less than the 1.25% of risk assets. However, with the probable implementation of the new Financial Accounting Standards Board's current expected credit loss model accounting standards (CECL) sometime in the near future, many credit unions will likely find it necessary to increase their ALLL to an amount in excess of 1.25% of their risk assets.

Once CECL is effective and the entire credit union industry is subject to the need for higher ALLL estimates, in conjunction with these ALLL balances being limited to 1.25% of risk assets in the RBC calculation, would cause credit unions to have an even greater impact on their future capital needs than is currently anticipated. In essence, the combination of CECL and the NCUA's proposed regulation could and would cause a double negative impact to the credit union industry.

Investment Risk Weighting

The FDIC assigned a risk weighting of 20 percent for all non-equity exposures to government sponsored enterprises (GSE's). NCUA's proposal bases risk weightings for all investment types on the weighted average life (WAL) of those investments, beginning with a risk weighting of 20 percent for investments with a WAL of one year or less and increasing to 200 percent for investments with a WAL of ten years or more.

Investment Risk Weightings		
Weighted Average Maturity	**NCUA Proposal**	**FDIC Rule**
Maturities of 0 to 1 years	20%	20%
Maturities of 1 to 3 years	50%	20%
Maturities of 3 to 5 years	75%	20%
Maturities of 5 to 10 years	150%	20%
Maturities in excess of 10 years	200%	20%

This difference between the FDIC rule and NCUA's proposal will significantly limit credit unions' ability to effectively manage their interest rate risk by laddering their investment portfolio to match liability maturities, while maximizing returns on their investment portfolio. To say that this proposal is intended to address interest rate risk may be misleading without consideration provided for the matching of investment maturities with those of the credit unions' liabilities. Furthermore, this could create a situation where credit unions may be at a competitive disadvantage with banks.

Residential Real Estate and Member Business Loan Risk Weightings

In addition, while the base risk weightings are similar, the NCUA's proposal assigns higher risk weightings for concentrations of residential real estate and member business loans (this tiered approach is not present in the FDIC's rule).

For example, the NCUA's proposal assigns a risk weighting of 50 percent for first mortgage real estate loans less than or equal to 25 percent of total assets, similar to the FDIC's rule. However, unlike the FDIC's rule, the NCUA's risk weighting under the proposed standard increases to 100 percent for concentrations of this loan type greater than 35 percent of total assets.

First Mortgage Risk Weightings (non-delinquent)		
	NCUA Proposal	**FDIC Rule**
Book balance less than 25% of assets	50%	50%
Book balance in excess of 25% and less than 35% of assets	75%	50%
Book balance in excess of 35% of assets	100%	50%

NCUA's proposal contains a similar tiered approach that exceeds the FDIC's rule for member business loans.

Business Loans		
	NCUA Proposal	FDIC Rule
Book balance less than 15% of assets	100%	100%
Book balance in excess of 15% and less than 25% of assets	150%	100%
Book balance in excess of 25% of assets	200%	100%

These differences between the NCUA's and FDIC's risk weightings for residential real estate and member business loans raise a few concerns.

First, the credit union industry has historically out-performed the banking industry in terms of lower net charge offs on these loan types, so these differences raise the question as to whether these higher risk weightings in comparison to banks are truly reflective of the risk these concentration levels represent to the credit union industry?

Second, the risk weightings proposed by NCUA are based purely on a concentration percentage of total assets; however, these risk weightings fail to consider that higher concentrations in a particular loan product will often be indicative of the credit union having extensive experience with that loan type which often improves profitability and reduces the related charge off percentages over time. For example, wouldn't a credit union that only recently began offering first mortgage real estate loans in the past few years with a concentration of 24 percent of their total assets (thus qualifying for a 50 percent risk weighting) pose a greater risk than a credit union with thirty years of experience with this loan product that has a concentration of 35 percent of their total assets (thus requiring a 100 percent risk weighting)? Certainly, there should be some penalty for credit unions with an excessive concentration for a particular loan type, but does a tiered approach with increasing risk weightings truly reflect the risk posed by the credit union prior to exceeding such a threshold for what is perceived as an excessive concentration?

Furthermore, could this also encourage credit unions to diversify their loan offerings, thus increasing their risk profile if such diversification causes them to venture into offerings where they are less experienced?

Perhaps it would be more beneficial to place a cap on concentrations for various loan types after which additional capital is required, and have a secondary consideration for a tiered approach in the event that a concentration is exhibiting indications of declining overall performance, which is indicative of increased risk to the share insurance fund. CLA would also recommend that the NCUA's proposal be revised to add consideration for member business loans secured by real estate and for any loan to value criteria that may mitigate the risk of this loan product.

Credit Union Service Organization (CUSO) Risk Weighting
NCUA's proposal assigns investments in CUSO's with a risk weighting of 250%, which is greater than any other category, with the exception of mortgage servicing rights and asset-backed investments that the credit union lacks a comprehensive understanding of the features of the investment that could materially affect its performance.

The assigned risk weighting for investments in CUSO's appears arbitrary, as it provides no consideration for the past performance or financial health of these entities. CUSO investment risk weightings should take such additional factors into consideration to provide a better assessment of the risk they pose to the credit union overall. Failure to consider the financial health and performance of the CUSO could severely limit credit unions' ability to invest in CUSO's which provide added services to memberships and a source of non-interest income for credit unions.

POTENTIAL FLAW FOR MORTGAGE LOANS

There is a flaw in the proposed standard that will only affect a limited number of credit unions. Mortgage loans sold as part of the Federal Home Loan Bank Mortgage Partnership Finance Program are treated as full-recourse under the proposed rule and are therefore included in the denominator of the risk-based capital ratio calculation at 75 percent; however, this loan product tends to have a very remote probability of loss. Hopefully, this risk weighting will be addressed in the final standard.

PHASE IN PERIOD

The NCUA has estimated that over 90 percent of credit unions currently categorized as well-capitalized under the existing capital rules would retain the well-capitalized designation if the proposed regulations were adopted.

This means a significant number of credit unions would drop below the well-capitalized threshold (NCUA estimates 189 credit unions would drop below well-capitalized).

NCUA's estimate of 189 credit unions fails to consider those credit unions that are between $40 million and $50 million. These credit unions that are just below the threshold for complex or any smaller credit unions that merge are likely going to become subject to the NCUA's proposed standard in the next few years as they continue to grow. The NCUA's estimate also does not provide consideration for those credit unions that under the proposed standards may have a risk based capital ratio equal to or just slightly greater than 10.5 percent, thus retaining the well-capitalized designation, but reducing the capital "cushion" these credit unions may have had prior to the proposed standard. Given these addition considerations, the NCUA's proposed effective date using an eighteen month implementation period seems insufficient and overly burdensome.

Most credit unions do not have access to supplemental capital. Unlike FDIC-insured banks, they are solely dependent upon earnings to build capital levels, which put them in a distinct market disadvantage with other financial institutions. Consequently, some credit unions will likely require additional time to raise sufficient capital to ensure they retain the well-capitalized designation under NCUA's proposed standard, and achieve any desired capital cushion they may have previously enjoyed as a result of their capital planning.

EXAMINER DISCRETION

NCUA's proposal also allows credit union examiners to impose additional minimum capital requirements on credit unions at their discretion, given adequate notice for the credit union, subject to an appeals process through the NCUA board. As many respondents have stated, this could significantly impact credit unions' ability to manage their capital given the level of uncertainty such discretionary supervisory actions will pose for credit unions' operations and capital planning, thereby undermining the decision making authority of credit union boards and management.

The banking industry has granted their examiners this tool, but banking examiners largely did not utilize this tool until after the damage to the banking system was already done. We do not discourage this tool; however, we stress that NCUA examiners should not abuse this privilege and any such decision should be carefully reviewed and monitored to ensure this is an effective and not arbitrary tool.

CONCLUSION

In closing, it appears that additional consideration should be given to the thresholds used to define "complex" credit unions subject to the proposed standard to more accurately reflect those credit unions whose operations are indicative of a need for a risk-based capital approach.

Additional consideration should also be given to the risk weightings provided under the NCUA proposed standard, particularly for those that include a tiered approach that exceeds the risk weightings provided under the FDIC's Basel III interim final rule, to more accurately reflect the risks specific to the credit union industry based on their historic performance and failures.

With the expected implementation of the new CECL accounting standard and other future accounting standards, we recommend that NCUA consider additional review of the risk limitations and weighting under the proposed standard to ensure that future expected accounting standards that can have a direct effect on the risk-ratings are addressed before this regulation is approved.

A longer and phased-in implementation period should be considered (i.e. three year phase-in period) to allow adequate time for all credit unions subject to this rule, and those soon to be subject to this rule, to increase their capital to levels consistent with the goals of their Management's and Boards' desire for a capital cushion in excess of the well-capitalized threshold.

Thank you for providing the opportunity to comment on this proposed standard for Prompt Corrective Action – Risk-Based Capital. We support the NCUA's efforts to enhance the risk-based capital system for the credit union industry.

Sincerely,

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cc: Gerard Poliquin, Secretary of the Board, National Credit Union Administration