May 27, 2014

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

RE: Comments on Proposed Rule: PCA - Risk-Based Capital; RIN 3133-AD77

Dear Gerald Poliquin,

I am writing on behalf of the California and Nevada Credit Union Leagues (Leagues), one of the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 10 million member-consumers. The Leagues welcome the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposed rule, Prompt Corrective Action (PCA)—Risk-Based Capital (RBC).

The NCUA's proposed RBC system is more restrictive and punitive on credit unions than RBC requirements for community banks and every other financial institution in the world. The Leagues vigorously oppose the proposed rule and recommend the NCUA withdrawal the proposal and reexamine the need for risk-based capital requirements. There is no evidence that risk-based capital requirements are effective. In fact, bank regulators have recently switched their focus back to leverage ratios.

Should the NCUA, after careful consideration and reexamination, still determine that a new RBC system is appropriate, the Leagues would support a sensible, lawful RBC system that gives credit unions parity with banks, includes congressional authority for supplemental capital for federally insured credit unions who want to use it meet capital requirements, and does not create a huge competitive disadvantage for credit unions.

Absent withdrawal of the proposal, the Leagues respectfully submit our comments and recommendations to address the following concerns with the prosed rule.

The Rule Is Unnecessary

The purpose of a prompt corrective action system and risk-based capital is to protect the National Credit Union Share Insurance Fund (NCUSIF). However, under the current PCA rules and risk-based net worth (RBNW) requirements, the NCUSIF performed very well and the credit union industry survived the worst economic crisis in 80 years.

Under NCUA's RBC proposal, federally insured credit unions (FICUs) in California and Nevada with assets greater than $40 million would need an additional $713.3 million in capital to maintain their current capital buffer to "well-capitalized." This proposed rule will deplete credit unions' capital cushions, hinder their ability to serve their members, particularly in the area of real estate and member business loans, and will constrain growth.

Given the past performance of the NCUSIF and the credit union industry, the Leagues question the need to replace the current RBNW requirements.

NCUA is Exceeding Their Authority

Former Speaker of the House Newt Gingrich and former U.S. Senator Alfonse D'Amato both commented to the NCUA clarifying that Congress never intended for NCUA to establish a risk-based capital standard for well-capitalized credit unions.

The Federal Credit Union Act (FCU Act) directs NCUA to devise a risk-based requirement, but the risk-based component for the well-capitalized threshold can be no higher than the component for the adequately capitalized level. Under NCUA's proposal, however, that is not what would happen. This goes against Congress' intent, the FCU Act, and the system of Prompt Corrective Action.

Basel III System

The NCUA's proposed RBC system is more restrictive and punitive than the Basel III system. The NCUA's proposed capital requirements are more extensive and cover several types of risk factors, whereas the Basel system only covers credit risk. This lack of parity disadvantages credit unions and the higher capital requirements will result in a reduced ability for credit unions to serve their members and communities.

The Leagues have compared the impact to FICUs in California and Nevada under NCUA's proposed RBC rule and the Basel III requirements for community banks. In that comparison, we found that 69% of California and Nevada FICUs with assets greater than $40 million fare better under the Basel III system.

Should the NCUA determine that a new RBC system is appropriate, the Leagues recommend the NCUA adopt the Basel III system rather than create a new, untested system.

Impact on Credit Unions

NCUA indicates that only 199 credit unions will be impacted by the proposed rule. They base this statement on the number of credit unions who would experience a decline in their PCA classifications, and further note that only 10 credit unions would collectively need to increase their capital by $63 million. This impact is grossly understated.

The NCUA does not consider those credit unions that maintain their same well-capitalized or adequately-capitalized levels but lose their capital cushion – the amount of capital credit unions currently hold above the well-capitalized level. The Credit Union National Association (CUNA) estimates an additional $7.3 billion in capital would be required nationally for FICUs to restore their capital cushions.

For FICUs in California and Nevada to maintain their current capital buffer to "well capitalized" under the Basel III system an additional $187 million in capital is needed; whereas under NCUA's RBC proposal $713.3 million in capital is needed—four times more than under Basel III.

Credit unions do not have access to supplemental capital and rely on retained earnings to build net worth. Therefore, raising this amount of additional capital will be challenging and will have adverse, unintended consequences. One option will be for credit unions to adjust their balance sheets to reduce "riskier" assets, meaning fewer mortgages and member business loans. The second option is to increase net income through higher loan rates, lower dividend rates, and increased fees. With either option, members lose and credit unions are placed in a competitive disadvantage. The proposed rule impedes credit unions ability to serve their members, continue to provide low cost, low fee products and services, and be competitive in the marketplace.

Interest Rate Risk

The proposed rule gives no consideration to balance sheet liability maturities and other mitigating features. Without considering the entire balance sheet the proposed rule overestimates interest rate risk and adds unreasonable capital requirements.

Risk Weightings

The NCUA's proposed risk weightings are not properly calibrated for credit unions. With the exception of consumer loans, the proposed risk weight ratings are the same as or higher than risk weights for community banks under Basel III.

Mortgage Loans and Member Business Loans

The proposed risk weightings for mortgage loans and member business loans are heavily focused on concentration risk and are double the comparable Basel III weights. This is extreme and unnecessary given that credit union mortgage and member business loans trend at about half the loss rates of community banks. Having higher risk weights for these loan types creates a huge competitive disadvantage for credit unions and will reduce the availability of mortgage and business loans to members.

The Leagues recommend the risk weighting be 50% for mortgage loans and 100% for member business loans, eliminating the concentration thresholds and consistent with Basel III requirements.

Delinquent Loans

The NCUA defines delinquent loans as 60 days or more past due; banks define them as 90 days. Even absent a RBC rule, the NCUA should change this definition and provide parity with banks.

Mortgage Servicing

The Leagues oppose the proposed 250% risk weight for mortgage servicing rights. These are salable assets and, per Generally Accepted Accounting Principles (GAAP), they are evaluated for potential impairment. The Leagues recommend a risk weight of 100%.

Investments

Under the proposed rule risk weights are based on the weighted average life of investments. The Leagues strongly recommend that risk weights not be categorized by maturity date and instead be based on investment type, with government issued guarantees at 20% and all others at 50%, consistent with Basel III requirements.

Corporate Deposits

Based upon the proposed risk weightings, it appears the NCUA believes the riskiest assets in which a credit union can invest are Corporate Credit Unions and CUSOs.

The proposed 200% risk weight for Corporate Credit Union Perpetual Capital is excessive and will have the unintended consequence of driving credit unions to the FRB instead of corporates. The Leagues recommend a risk weight of 100% for cash on deposits with corporates.

CUSO Loans and Investments

CUSOs exist to provide credit union members with innovative products and services and to create revenue streams and efficiencies for credit unions. Under the proposed rule, investments in CUSOs carry a risk weight of 250%. This risk weight is excessive and punitive, assumes all CUSO investments are risky, and treats all CUSOs the same.

In addition, the proposed rule does not explain the difference in proposed risk weights of 250% for investments in CUSOs and a 100% for loans to CUSOs. These proposed risk weights imply that investments to CUSOs are 2.5 times riskier than loans to CUSOs.

The Leagues recommend investments in CUSOs should carry a 100% risk weighting based on the following risk mitigating factors. First, GAAP requires credit unions to evaluate the asset for potential impairment. Second, the majority of CUSOs are Limited Liability Corporations (LLCs) and the credit union would be protected under the LLC structure. Lastly, the stated purpose of NCUA's CUSO rule, which becomes effective in June 2014, is to reduce risk exposure to credit unions.

Numerator

NCUSIF Deposit

Under the proposed rule, the NCUSIF deposit is deducted from equity in the RBC numerator. The NCUSIF deposit is an asset of the credit union. The deposit would be returned to the credit union should they convert to private insurance or to a bank charter.

The NCUA has stated that the NCUSIF deposit is an asset on NCUA's balance sheet and therefore cannot also be an asset on the credit union's balance sheet. The Leagues note that the FHLB has this same issue and both sides count the insurance deposit as an asset.

The Leagues recommend the NCUSIF 1% deposit be treated as a credit union asset with a risk weighting of 100% or lower.

Goodwill

Under the proposed rule, goodwill is deducted from equity in the RBC numerator. This deduction serves as disincentive for potential mergers with credit unions. The Leagues recommend goodwill not be deducted.

Allowance for Loan and Lease Loss (ALLL)

The proposed rule allows for an ALLL credit of up to 1.25% of total risk assets, while the current RBNW calculation allows a credit of 1.5% of loans.

The proposal will penalize a credit union for high ALLL even as the NCUA has encouraged larger ALLL balances. In addition, the Leagues are very concerned that if the FASB proposal on accounting for credit losses using the CECL model is approved, then credit unions' allowances will significantly increase and have a devastating impact credit unions' net worth.

The Leagues recommend the RBC rule allow a credit to the numerator for the full and GAAP determined ALLL balance.

Individual Minimum Capital Requirements

The proposed rule gives NCUA staff authority to require even higher capital for individual credit unions. This authority effectively substitutes an examiner's judgment for that of the credit union's management and board of directors. This highly subjective element should be stricken from the rule.

While NCUA has verbally stated that individual minimum capital requirements would require NCUA Board approval, the proposed rule, as drafted, gives NCUA staff this authority and allows a credit union to appeal to the NCUA Board.

The proposed rule states that ''material supervisory determinations,'' including decisions to require prompt corrective action, made by NCUA officials other than the NCUA Board may be appealed to the NCUA Board. The proposal then clarifies that decisions of NCUA staff to impose individual minimum capital requirements on a credit union would continue to be treated as ''material supervisory determinations.''

Again, the Leagues strongly oppose this section of the proposed rule and recommend it be eliminated in its entirety. If this authority to require individual minimum capital requirement it is not eliminated, an independent third-party should be established to mediate any appeal between a credit union and the NCUA; the NCUA should not be the examiner, the regulator, and the "appealed to" entity.

Implementation period

The proposed rule would establish an effective date of 18 months after a final rule is issued. This proposed implementation period is grossly inadequate. Credit unions cannot access supplemental capital and will need a reasonable period of time to accumulate additional capital through retained earnings or adjust their balance sheets. In addition, compliance with the RBC requirements may change credit unions' entire business models and/or strategic plans. These adjustments need careful consideration and planning.

In contrast to NCUA's proposed 18 month implementation period, community banks will have had nearly nine years to implement Basel III standards. The Leagues recommend a minimum five year, phased-in approach similar to Basel III.

Conclusion

In conclusion, the Leagues strongly oppose the proposed rule as currently drafted and believe it should be withdrawn and reconsidered. We believe the proposed rule will have the following unintended consequences: (1) constrict mortgage and member business loans and result in less credit available to credit union members and their communities, (2) cause larger credit unions to consider converting to bank charters with less stringent and oppressive capital requirements and access to supplemental capital, and (3) create a huge competitive disadvantage for credit unions in the marketplace, hindering their ability to serve their members.

It is the Leagues' hope that the NCUA will carefully consider all of the comments received on this proposed rule and based on those comments either withdraw the proposal or reissue for comments a second proposed rulemaking that adopts the Basel III system rather than create a new, untested system. Credit unions and other stakeholders should be given ample time to review and comment on any revisions.

The Leagues would support a sensible, lawful RBC system that gives credit unions parity with banks, includes congressional authority for supplemental capital for federally insured credit unions who want to use it meet capital requirements, and does not create a huge competitive disadvantage for credit unions.

Thank you for the opportunity to comment on the proposed rule for PCA—Risk-Based Capital and for considering our views.

Sincerely,

Diana R. Dykstra
President and CEO
California and Nevada Credit Union Leagues

cc: CCUL