From:	Yu, Irving
To:	_Regulatory Comments
Subject:	Irving Yu - Comments on Proposed Rule: PCA - Risk-Based Capital
Date:	Tuesday, May 27, 2014 5:25:26 PM

Dear Mr. Poliquin,

Wescom appreciates the opportunity to comment on the National Credit Union Administration (NCUA) Board's proposal to revise Prompt Corrective Action related to Risk-Based Capital. Wescom serves Southern California residents with 200,000 members and $2.7 billion in assets. The need to modernize capital standards in order to identify excessive risk in credit union balance sheets is understandable. However, the current proposal will have negative effects for Wescom members, as well as the credit union industry as a whole. There are several concerns we have with this proposal that we address below.

- **Investment Risk Weights**

  The NCUA states that it is "required by statute to maintain capital and other standards for credit unions that are modern and comparable to those of other federal regulators" and yet it plans to impose higher risk weights than those levied on banks. The NCUA's proposed regulation goes much further than the often sited Basel Capital Accords upon which bank regulation is established by setting risk weights between 50% and 200% for all U.S. Agency securities with average lives greater than one year. In contrast, bank regulation sets a 20% risk weight for the same investments. The risk weights that the NCUA has selected are more punitive than comparable.

  A significant difference exists between the NCUA's proposed rule and the Basel III rule imposed on banks with regard to overnight cash on deposit at the Federal Reserve. The NCUA proposes a 20% risk weighting on these funds, in contrast to a 0% risk weight for banks. Given that the Federal Reserve has been designated as a source for emergency liquidity for the entire credit union industry, there appears to be little risk in holding cash balance at the Federal Reserve. This risk weight is not consistent with NCUA policy.

  While bank regulation focuses on controlling credit risk, the NCUA proposed regulation attempts to control interest rate risk as well by requiring higher risk weights as the weighted average life of a security increases. However, this proposal is misguided when a 30 year U.S. Treasury bond is assigned a zero percent risk weight and a three year agency CMO is given a 75% risk weight. The 30 year Treasury bond has significantly more interest rate risk than does the CMO, and thus a greater impact on NEV. The risk weights the NCUA has assigned are not commensurate with the actual level of risk in the securities.

  Another inconsistency within the proposed rule is exemplified with regard to mortgage loans versus mortgage pools. A 30 year mortgage loan on the books has considerably more credit risk than does a Fannie Mae or Freddie Mac pass-through security since its principal is guaranteed by each agency. However, the NCUA assigns the loan a risk weight of 50%, while the risk weight for the pass-through is 150%! The proposed risk weightings are not logical.

By regulating all the perceived risks out of a credit union's portfolio, most of the reward is eliminated as well. Credit unions will be at a distinct competitive disadvantage when required to hold more capital than banks given the same set of assets. This proposal translates into higher product costs and lower dividends thereby undermining member loyalty. To prevent such a situation the risk weights for investments should be aligned with those of banks.

- **CUSO Investment**

  The proposal assigns a 250% risk weighting on investment in a CUSO, while current regulation already limits the amount a credit union may contribute. This onerous risk weight will discourage collaboration and expense sharing amongst credit unions who are seeking ways to consolidate functions and reduce operating expenses. In addition, well managed CUSOs can increase a credit union's profitability by contributing to increased non-interest income. In many cases CUSOs are set up as limited liability companies, structured to decrease the risks to credit unions. CUSO investments should be risk weighted at no more than 100%.

- **Individual Minimum Capital Ratio**

  Within the proposal the NCUA assumes authority to require a higher minimum risk-based capital ratio for individual credit unions based on NCUA "expertise". Allowing examiners to have such discretion will lead to inconsistent interpretation and unfair application. Any rule must be clear and not permit subjectivity. This section should be eliminated.

- **NCUSIF Deposit**

  The National Credit Union Share Insurance Fund 1% deposit is excluded in the risk-based capital calculation. The NCUSIF deposit is a valid asset that can be refunded for a variety of reasons. It also acts as an additional buffer against NCUSIF losses, along with credit union capital. If a credit union converted to a bank charter, regulation would permit the inclusion of this deposit. The NCUSIF deposit should not be deducted from the risk-based capital numerator.

- **Mortgage Servicing Assets**

  Rising interest rates and the potential negative impact on credit unions is understandably a major concern of the NCUA. However, interest rate risk can be reduced by retaining mortgage servicing assets (MSA). Therefore, the proposal to set the risk weight for MSAs at 250% is not reasonable. This weighting is excessive and creates less incentive to build a servicing portfolio which helps protect a credit union's earnings in a rising rate environment. The risk weight should be set to 100%.

- **Allowance for Loan and Lease Loss**

  The proposed regulation permits an addition to the numerator of up to 1.25% of total risk assets for the Allowance for Loan and Lease Loss (ALLL). Given that FASBs proposed new standard on the allowance will most likely increase normal reserves Wescom believes that more of this required reserve should count toward capital.

- **Implementation Timeline**

  The proposal provides for an 18 month implementation time frame for credit unions to comply. Given the magnitude of any new risk-based capital rule this window is much too short. Credit unions may wish to alter the composition of their balance sheet as a response to a new rule, but 18 months does not allow for an adequate transition period. Basel III afforded banks a 5 year implementation period. If any risk-based capital rule is adopted a multi-year implementation period should be used.

Management's ability to serve their members by managing the actual risk of assets will be damaged if this proposal is adopted in its present form. Any risk-based capital rule should not focus entirely on the asset side of the balance sheet but should take into consideration liabilities and off-balance sheet items as well. Many credit unions are able to mitigate interest rate risk with borrowings or a derivative strategy. However, the current proposal ignores these options and assumes a credit union has short liabilities. This proposal prevents management from optimizing its asset/liability position by forcing it into short asset classes. To effectively manage interest rate risk all ALM factors must be considered. In its present form, the proposed rule can easily overestimate the interest rate risk and create unreasonable and unnecessary capital requirements. This is not in the best interests of credit unions, nor their members.

Credit unions should not be required to have more capital than is required of a bank given the same set of assets. Nor should each Prompt Corrective Action level be set higher than Basel III sets for banks. The NCUA should not adopt a rule which actually penalizes credit unions for choosing a charter which better serves the consumer. The bottom line is that capital requirements are not a substitute for proper credit union management, but if instituted it should not put the industry at a competitive disadvantage. Given the many concerns with this proposal and the dramatic, adverse effect it would have on credit unions, Wescom believes the rule as proposed must be reconsidered.

Thank you for the opportunity to comment on this proposed rule and for considering our views on risk-based capital requirements.

Sincerely,

Irving Yu
Chief Investment Officer
Wescom Credit Union
123 S. Marengo Avenue, Pasadena, CA 91101
626.535.1378
iyu@wescom.org