The Wisconsin Credit Union League
One League, One Focus - Your Success!

Submitted via email: regcomments@ncua.gov

May 28, 2014

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

Re: Comment to Proposed Prompt Corrective Action: Risk Based Capital Rule
RIN 3133-AD77

Dear Mr. Poliquin:

On behalf of Wisconsin's credit unions and their 2.4 million members, the Wisconsin Credit Union League welcomes the opportunity to comment on the National Credit Union Administration's (NCUA's) Proposed Prompt Corrective Action: Risk Based Capital (RBC) Rule.

While we understand that the NCUA must take steps to ensure the safety and soundness of the nation's federally insured credit unions, and while we applaud efforts to protect the credit union system, we urge the NCUA – as strongly as we can – to abandon the RBC proposal in its current form. The proposal would impose an unnecessary compliance and financial burden on Wisconsin credit unions. It would discourage mortgage lending and member business lending – services our members need and programs many credit unions rely upon to survive. It would lead to higher loan rates, lower dividend rates, and increased fees for members. Even if an RBC program were appropriate in some form, the risk-weighting system now being proposed is fundamentally flawed and far harsher than the Basel III standards for community banks.

Though the proposed rule says so, does the NCUA really mean that:

- Every credit union with more than $50 million in assets is complex, and every credit union under that size is not – no matter what their portfolios of assets and liabilities?

- It's riskier for to invest in a CUSO that offers efficient, cost-effective back office operations support than for the credit union to handle the duties in-house?

- It's just as risky to invest in a CUSO that originates subprime loans as in a CUSO that offers IT services?

- It's riskier for credit unions with substantial member business lending (MBL) experience and success to have higher concentrations of MBLs than it is for community banks to do so, even though credit unions have had a significantly lower default rate on these loans?

- It's riskier for credit unions to have higher concentrations of fully-secured, 1-4 unit home loans than it is for community banks to do so?

- It’s just as risky for a credit union to invest in a 10-year government-insured certificate of deposit as for a bank to invest in a short-term junk bond?

- It’s fair and *not* risky to impose an 18-month implementation schedule on credit unions, while banks are given five years to implement Basel III standards? And this especially when a credit union can increase capital only through reserved earnings, but the proposed rule would unnecessarily restrict a credit union’s ability to build that capital?

This just cannot be. We urge the NCUA to formulate a new proposal better tailored to credit union risks and needs.

We wholeheartedly agree with the points expressed in the recent letter to the NCUA from Representatives King and Meeks, which was signed by a bipartisan group of more than 320 other members of the U.S. House of Representatives:

- The NCUA should take into account the costs and burdens of implementing new risk-based capital requirements beyond current ratios.

- The NCUA should provide justification and more clarity as to why the risk weights differ from those applied to community banks.

- The NCUA should give credit unions more time to comply with any changes to capital reserve requirements.

The proposal is unnecessary

The NCUA should reconsider whether a system of risk-based capital reserves is even needed for federally insured credit unions, since their high net worth leverage ratio requirement already demands higher capital levels than similarly sized banks. The NCUA has failed to demonstrate the necessity of a new RBC regimen, given the historical safety and soundness of credit unions (especially obvious during the recession). The NCUA already has tools to manage interest rate risk, concentration risk, investment parameters, and other concerns. Why stress credit unions further by requiring more capital and tying their hands as they struggle to grow and serve their members?

As former Senator Alfonse D’Amato (R-N.Y.) noted in his recent letter to the NCUA, the basic net worth standards for a credit union to be adequately or well capitalized are already higher than those set for banks. Because of this higher “pure” net worth requirement, Congress deliberately did not intend to allow for a separate risk-based requirement for credit unions to be well capitalized.

Implementation of the RBC system, as proposed, would serve only to hamper growth and restrict credit unions’ ability to compete – just the opposite of what Congress intended. The NCUA has failed to consider the costs and burdens of implementing new RBC requirements beyond the current leverage ratio.

The proposal would impose undue costs and burdens on Wisconsin credit unions that are not “complex”

The NCUA has underestimated the impact its RBC proposal would have on credit unions. The proposal notes that 90% of credit unions with more than $50 million in assets would still meet the “minimum risk-based capital requirement under the rule.” This ignores the fact that examiners routinely expect credit unions to maintain a cushion above the bare minimum required for “well capitalized” status.

In addition, the NCUA has only considered the impact this rule would have on "complex" credit unions that already have more than $50 million in assets. By the time the RBC plan is finalized and fully implemented, many credit unions that now have $40 million in assets are likely to grow above $50 million.

Furthermore, the proposal would arbitrarily treat credit unions as "complex" the moment their assets cross the $50 million mark. Credit unions at that asset size should still be considered small, since they are likely to have relatively simply operations and limited staff. The RBC proposal casts too wide a net and would compound the already staggering compliance burden these credit unions face. The definition of "complex" should take into account credit unions' portfolios of assets and liabilities, not asset size alone.

The real impact on Wisconsin credit unions would be more significant than the NCUA has estimated. Here's what it would mean for Wisconsin's 71 federally-insured credit unions with assets over $40 million:

- Five of them would fall from well capitalized to adequately capitalized.
- Their current cushion over well capitalized – 357 basis points on total assets – would decline to 261 basis points. That is a drop of 95 basis points.
- Cushions over well capitalized would shrink by a combined total of $200 million.
- A total of 59 credit unions – 83% – would see their cushions over well capitalized shrink.
- For 17 of them, the cushion would be reduced by at least 100 basis points on assets.
- The median increase in capital needed to maintain the current cushion above well capitalized would be 86 basis points on assets.

The NCUA has failed to demonstrate that the RBC proposal is necessary in its current draconian form. The credit union system withstood the worst financial crisis in 80 years, yet this rule would require U.S. credit unions to hold more than $7 billion in additional capital. This is especially harmful to credit unions, as they cannot raise capital except from retained earnings.

The proposed risk-weighting system is unsound

Even if an RBC program were appropriate in some form, the proposed risk-weighting system is fundamentally flawed. We urge the NCUA to rescind its proposal and "go back to the drawing board." Credit unions need a system that:

- Properly captures the risks involved in their lending and investment decisions;
- Is fair and equivalent to the system imposed on community banks; and
- Allows credit unions to base decisions on safety, soundness, and member service, rather than compliance with excessive capital reserve requirements.

The risk weights would not properly capture risks

The proposal increases the risk weight for certain types of loans – including real estate loans and MBLs – based *only* on their concentrations in a credit union's portfolio. This system fails to predict risk adequately.

For example, Wisconsin credit unions that have developed MBL expertise would be unfairly penalized simply because MBLs represent a relatively high concentration of their loan portfolios. Thanks to sound MBL policies, experienced staff, strong controls, and strict underwriting standards, these credit unions' MBL portfolios are actually less risky than the loans of inexperienced business lenders with few MBLs. Other metrics may be better predictors of risk, but the RBC proposal ignores them. It fails to consider whether an MBL is secured or unsecured, the lender's underwriting standards, loan-to-value ratios, collateral type, or other indicia of loan quality. Additionally, historic loan losses by individual credit unions should be included as an offset. A credit union that has never had an MBL or mortgage default should not be subject to the same loan concentration thresholds as a credit union with significant default history.

If the NCUA retains the concentration-risk focus of its risk weighting system, it should consider more reasonable concentration escalators. The proposed concentration thresholds are so low that they would force credit unions to make choices based on compliance rather than safety and soundness or member service, simply to avoid going over a concentration threshold.

Risk weights on the investment side would be based *solely* on interest rate risk – weighted average life – regardless of other metrics of investment safety. The proposal ignores variable rate investments or amortization features that mitigate interest rate risk, just as it ignores whether an investment is guaranteed. Wisconsin credit unions have seen a growth in deposits and made the strategic decision to build a sound investment portfolio based on prudent, long-term investments. They would be unfairly penalized by this proposal, which is based on the short-sighted assumption that a rising interest-rate environment is the overriding risk. In addition, using higher risk weights on long-term assets to deal with interest-rate risk is misleading without also considering the other side of the credit union's balance sheet and factoring in liability maturities. We urge the NCUA to scrap its risk-weighting system and find a fairer, more accurate means of measuring investment risks that goes beyond maturity length.

The 250% risk-weighting being proposed for all CUSO investments is particularly astonishing. CUSOs are invaluable resources for credit unions, and they should not be treated as if they were illiquid small business investments. CUSOs provide services that members need but that credit unions might not be able to provide efficiently on their own; they increase credit union profitability by contributing to increased loan production; they reduce operating expenses by allowing credit unions to pool resources; and they provide expertise and thus reduce risks. Yet the 250% risk weighting would likely precipitate CUSO failures as credit unions are forced to divest from them in order to maintain capital. At the very least, the proposal would discourage credit unions from investing in CUSOs. This cannot be what the NCUA intends.

It is difficult to understand how the NCUA can treat CUSOs as such risky investments when it recently amended its rules to address accounting, financial statements, and audits for federally insured credit unions' CUSOs. The proposal fails to justify such a harsh risk weight, appearing instead to assume that CUSOs present a grave risk despite NCUA oversight. The NCUA brushes with too broad a brush, treating all CUSO investments as equally – and highly – risky. CUSO investments should be risk-weighted at no more than 100%.

The risk weights would be far higher than those imposed on community banks

A number of the risk weightings, especially for MBLs and mortgage concentrations as well as for investments, are not properly calibrated for credit unions and would put them at a competitive disadvantage. In comparison to the FDIC's risk based capital for banks under Basel III, the NCUA approach is punitive and troubling.

For example, on the loan side:

- Basel III gives a 50% risk weighting to *all* 1- to 4-family mortgage loans, regardless of concentration. The NCUA's RBC proposal starts with the same 50% risk weighting, but only for non-delinquent 1st mortgage real estate loans that make up less than 25% of the assets in a credit union's portfolio. The risk weighting jumps to 75% at 25-35% of assets, and finally hits 100% for those over 35% of assets.

- Similarly for both other mortgage loans (such as second mortgages) and for MBLs, banks have a 100% risk weighting under Basel III – regardless of concentration. Credit union risk weights are up to twice as high: MBLs start at a 100% risk weight, but only up to 10% of assets; after that, they jump to 150% risk weight at 15-25% concentration levels, and then to 200% at higher concentrations. This makes no sense, especially given that credit union MBL losses have averaged 50% less than those of similar sized commercial banks.

On the investment side, the RBC's proposed risk weights are just as skewed. For example, a credit union that invests in a safe NCUA- or FDIC-insured certificate would face a risk-weighting that starts at 20% for investments with a weighted-average life of one year or less, but a 200% risk weight if the maturity is more than 10 years. Basel III sets a 200% risk weight only for an investment "below investment grade." In other words, the NCUA says that a credit union's investment in government-insured, 10-year certificates is just as risky as a bank's investment in junk bonds!

Credit unions didn't precipitate the recent financial crisis, and the losses caused by credit union failures pale in comparison to those caused by banks. So why punish credit unions by setting risk weights so far out of line with the standards imposed on banks? Applying substantially higher risk weights to credit unions than apply to community banks seems neither necessary nor reasonable.

The risk weights would unfairly hamper Wisconsin credit unions' strategic planning

Credit unions should base their decisions on safety, soundness, and member service. The RBC proposal would force them to focus instead on compliance with excessive capital reserve requirements.

The proposed risk-weights would create a strong disincentive for credit unions to engage in mortgage lending, to make MBLs, to invest in CUSOs, or to hold long-term investments – all to the detriment of members. Those consequences are not justifiable. Particularly troubling, the risk weighting for MBLs would have a chilling effect on member business lending, which credit unions may need to survive. This sends a mixed message in light of the NCUA's advocacy for a higher MBL cap and in spite of how well credit unions fared compared to banks during the recession. Rural communities would be particularly hard hit if credit unions reduce business lending. In some cases, credit unions are one of the few alternatives in rural areas for agricultural and small business lending. The impact this could have on already struggling rural economies could be devastating.

Moreover, to maintain adequate cushions, credit unions would look to net income – increasing interest income, reducing interest expense, rationing services, or increasing fee income – all to the detriment of members/owners. Is this really what the NCUA wants?

Comments from our Wisconsin credit unions bear out the consequences they predict if the RBC proposal is adopted:

- "We already have been contacted by a firm specializing in charter changes. … By restricting our historically successful business model, we would be forced to look at our options."
- "Our only option to raise … capital is via retained earnings – funds that could be used to provide better services, grow our credit union and improve our ROI."
- "This proposal would make strong incentives not to make mortgages. We would not be serving our members' needs."
- "The proposal would severely restrict our ability to offer mortgages and member business loans."
- "Instead of making sound decisions for our individual credit union and our members, we will be watching how each new loan will potentially affect [our concentration] …."
- "This could impact long-term growth strategies with products, services, and potential members. We would be managing more to the numbers than the needs of our members."
- "We do have a few longer term investments; under the new rules we may or may not choose to make any future investments of this type, even if after a thorough analysis our management and board feel it would be prudent for our credit union."
- "In our [real estate loan] mix we have a really good number of low loan-to-value mortgages for long-term members with excellent credit which are great loans with extremely low risk. It would be a blow to the CU and a disservice to our members if at some point we had to discontinue or restrict this type of lending due simply due to the weighting given to these types of loans."

NCUSIF deposits, goodwill, and other intangibles should not be deducted from the RBC calculations

The RBC proposal would mistakenly ignore the NCUSIF 1% deposit in its calculations. The NCUSIF deposit is a valid asset under generally accepted accounting principles. It can be refunded for various reasons. For example, in a voluntarily liquidation, it is an asset that would be available to meet claims on the credit union – unlike an intangible asset. Also, if a credit union were to convert to a bank charter, the NCUSIF deposit would then be included in the risk based capital numerator under Basel III. Failing to recognize the deposit as a credit union asset is just one more strike against any meaningful comparability between the RBC proposal and the standards for community banks. We strongly urge not deducting the NCUSIF deposit from the risk-based capital numerator.

The removal of goodwill from the calculation is also troubling. The NCUA should better explain its reasons for that aspect of the proposal. Many credit unions rely on goodwill as an asset, so that healthy credit unions can merge with troubled credit unions at no cost to the NCUSIF. Deducting goodwill from assets would remove any incentive for healthy credit unions to accept mergers. Any RBC system should properly account for assets like goodwill that represent a potential future benefit.

The “Individual Minimum Capital Requirement” would create too much uncertainty

Under the proposal, the NCUA would have discretion to increase a credit union’s individual risk-based capital requirement, based only on an examiner’s subjective determination that the credit union’s capital “is or may” become inadequate, regardless of the credit union’s actual RBC ratio. This would authorize the NCUA to impose capital requirements that exceed even well-capitalized levels. Doing so on a case-by-case basis would give examiners far too much discretion and create too much uncertainty for credit unions. How could credit unions be expected to manage their portfolios and adhere to the RBC standards if examiners can “move the goalposts” whenever they see fit?

This rule, as written, would already rain competitive disadvantage and hardship on credit unions. To allow additional “just because I said so” authority for individual examiners compounds these effects. It should be eliminated from the proposal.

If not eliminated, then the system should at least be modified to give credit unions a meaningful appeals process. Simply requiring “reasonable prior notice” (the deadline for which is not defined) and then giving the credit union 30 days to respond or to seek a recommendation from the NCUA Ombudsman is woefully inadequate.

The proposed implementation timeframe is too short

The proposed 18-month timeframe for implementation is too short. Credit unions should be given ample time to restructure their balance sheets to meet the standards in the final rule. Any rule increasing a capital requirement for credit unions should be phased in over five years. Community banks were given a five-year transition period under Basel III. Credit unions, which do not have the ability to raise capital as banks do, need at least as long to realign their balance sheets. Credit unions are already staggering under the pressures of all the new and modified regulations, as well as the confines of building reserves only from retained earnings. More credit unions should not crumble just because of a short implementation timeframe for an onerous – and needless – new rule.

In summary, the Wisconsin Credit Union League urges the NCUA to scrap its unnecessary RBC proposal, or at the very least to overhaul it and issue a revised proposal for comments. In its current form, the rule would create an unjustified compliance and financial burden for credit unions. It would discourage mortgage lending and member business lending – services our members need and programs many credit unions rely upon to survive. It would lead to higher loan rates, lower dividend rates, and increased fees for members. Implementing the rule as it is now written would profoundly and negatively impact not just Wisconsin credit unions, but the U.S. credit union movement as a whole – as well as all credit union members nationwide.

Thank you.

Sincerely,

Paul Guttormsson
Legal Counsel
The Wisconsin Credit Union League