From:	Reagan Logsdon
To:	_Regulatory Comments
Subject:	Sound Credit Union--Comments on Proposed Rule: PCA--Risk-Based Capital
Date:	Tuesday, May 27, 2014 8:45:02 PM
Attachments:	image003.png

May 27, 2014

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

Subject: Prompt Corrective Action - Risk Based Capital; RIN 3133-AD77

Dear Mr. Poliquin,

Sound Credit Union is an organization with over $1.1 billion in assets and close to 100,000 members. We appreciate the opportunity to offer comments on the National Credit Union Administration's Risk Based Net Worth rule, and urge the NCUA to exercise their discretionary rulemaking powers relating to this rule. We believe it is imperative for the Chair to advocate for necessary statutory changes, prior to issuing a final rule to ensure the safety and soundness of our regulatory system.

Although our credit union would remain well capitalized with the proposed rule, our capital cushion would shrink substantially—decreasing by a total of over $35 million if the proposal were in effect today. Our current cushion of 544 basis points would decline to 213 basis points, a decrease of over 330 basis points. For reference, Sound earned 163 basis points of ROA in 2013.

Credit unions are very different than banks and should be treated differently. Even the most complex credit unions have a different mix of products and services with far less exposure to high risk activities, such as trading, private equity, and counterparty exposure from derivatives and financing transactions. Furthermore, exposure to commercial real estate and commercial industrial lending is minimal in comparison. Also, credit unions do not have the same ability as banks to raise supplemental capital.

General Observations

1. The weightings for balance sheet items are significantly different than those required for banks by the Third Basel Accord (Basel III). The proposed regulation seems to use restrictive percentages from Basel III, while ignoring Basel III standards that may be more

liberal in other areas.

2. The proposed capital levels and weightings will likely hamper merger activity and discourage healthy, well capitalized credit unions from engaging in mergers with undercapitalized credit unions since, for example, the proposal forces credit unions into less profitable asset growth. Additionally, the exclusion of goodwill from risk-based capital disincentivizes merger activity. Discouraging merger activity prevents healthy industry consolidation; this consolidation ultimately lowers the risk to the NCUSIF by combining unhealthy credit unions with stronger ones.

3. It has been demonstrated that the regulatory system in place for natural person credit unions was sufficient to weather a historic crisis. Programs were created and serious actions were taken, but natural person credit unions required relatively little assistance and have seen very few large failures. The majority of losses suffered by the NCUA were due to the failure of corporate credit unions, which had their capital standards increased appropriately.

4. The credit union industry would require approximately $6.5 - $7.0 billion in additional capital to retain the same buffers that exist today to be considered well capitalized. We do not believe the credit union industry is currently undercapitalized to this extent.

Specific Observations and Recommendations

1. Our greatest concern is that the proposal allows the NCUA to establish individual minimum capital requirements that may be greater than the RBC requirement. Additionally, the criteria under which the NCUA could require a higher individual minimum capital requirement are broadly defined. Since the RBC proposal is intended to address most major risk areas, including interest rate, concentration, liquidity, and credit risks, we do not believe the NCUA should have broad subjective powers to require higher capital levels.

   <u>Recommendation</u>**:** Limit and specifically define the circumstances under which the NCUA can require a higher individual minimum capital requirement.

2. If the Financial Accounting Standards Board's (FASB) current credit loss proposal is passed, credit unions will be required to significantly increase their allowance for loan and lease losses (ALLL). We believe the proposed RBC rule, which allows an ALLL credit of 1.25% of total risk weighted assets, does not address the significant one-time increase in the ALLL that will result if the FASB proposal is implemented, including the need to allow a greater amount of the ALLL to be included in risk-based capital.

   <u>Recommendation</u>: Add language to the proposal that states that the ALLL credit will be

increased if the FASB proposal is implemented.

3. If we fund a 1st T.D. real estate loan, and total 1st T.D. real estate loans are equal to or less than 25% of assets, we would be required to assign a 50% risk weighting to these loans, and would have credit risk in the event of a default. If we buy a 4% Fannie Mae mortgage-backed security with no credit risk, and a weighted average life similar to that of our 1st T.D. real estate loans, we would be required to assign a 150% risk weighting to the mortgage-backed security. We do not understand the logic of this type of risk weighting, which causes a lower-risk asset to have a higher risk weighting.

   Recommendation**:** Amend the weighting system to properly reflect the level of credit risk associated with 1st T.D. loans and agency mortgage-backed securities.

4. Loans made to borrowers with superior credit histories are treated in the same manner as loans made to borrowers with poor credit histories. In the mortgage area, loans made to borrowers with low loan-to-value (LTV) ratios are treated in the same manner as loans made to borrowers with high LTVs.

   Recommendation**:** Expand the proposed regulation to deal with credit and collateral risks.

5. The proposed rule calls for an 18-month implementation period for credit unions to become compliant. The new Basel III standards allow banks up to four to five years to comply. Additional time to comply with any final regulation is needed to allow credit unions to adjust their balance sheets in an orderly fashion.

   Recommendation**:** Amend the proposed rule to allow credit unions up to five years from the date of adoption to comply.

Conclusions

We support a risk based capital system designed from the ground up for credit unions, not layered over the top of existing regulation. We hope that our suggestions, comments and concerns, help the board create a Risk Based Capital system that is tailored for credit unions.

Thank you for the opportunity to comment on this issue. We would be pleased to answer any questions you may have.

Respectfully,

Richard C. Brandsma

Richard Brandsma
President & CEO
Sound Credit Union
PO Box 1595
Tacoma WA 98401
253.597.7600
rbrandsma@soundcu.com