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Date: May 27, 2014

The Honorable Debbie Matz, Chairman
The Honorable Michael E. Fryzel, Board Member
The Honorable Rick Metzger, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: Proposed Changes to National Credit Union Administration's
Prompt Corrective Action Rules - Proposed Rule on Risk Based Capital

Dear Chairman Matz, Board Member Fryzel and Board Member Metzger:

Bourns Employees Federal Credit Union (BEFCU) appreciates the opportunity to submit our comments regarding the National Credit Union Administration's (NCUA) proposed rule on Risk Based Capital (RBC) that revises the NCUA's current risk-based net worth standards under the agency's Prompt Corrective Action (PCA) rules.

BEFCU is one the many credit unions that would not immediately be impacted by the proposed rule change since it assets are under $50 million; however, BEFCU will be affected in the not too distant future and therefore believes it prudent to list our concerns and worries over the proposed rule change.

The following responds to specific aspects of the rule; BEFCU will not comment on comparative regulatory requirements or Basel III implications. These latter issues have been comprehensively addressed by others.

Complex Credit Union

Although the current rule does not directly affect BEFCU since it is not a "complex" credit union (i.e., by asset size), the definition used by the NCUA to define what a "complex" credit union is, is a sweeping oversimplification that penalizes credit unions with simple yet profitable, well run operations.

The makeup of a credit union's balance sheet should be what is used to define if it is a "complex" credit union. Diversified investment portfolios (i.e., a variety of securities), hedging

operations, member business loans, a sizeable mortgage loan portfolio (i.e., compared to a credit union's total loan portfolio and/or assets), CUSO investments, and/or concentration of a loan product should be used to classify a credit union as "complex" or not "complex" if these are present.

There are many well run credit unions that have a well-balanced loan portfolio with just three or four loan products: auto loans, Visa cards, and consumer loans. They do not have mortgage loans, member business loans, security investments, or, investments in CUSOs. Yet these "simple" well run credit unions are "complex" if their asset size is over $50 million—and they are subject to the same requirements as truly "complex" credit unions (which are often larger and more profitable).

The simple, well-run credit unions are not rewarded for good behavior; instead, the new definition gives them little incentive to maintain an uncomplicated operation—it actually drives behavior in the wrong direction.

Section 702.104(b): Risk-based Capital Ratio Numerator

The proposal removes three items from the numerator: NCUSIF deposit, Goodwill, and Other intangible assets (for purposes of this response, "identified losses not reflected as adjustment to component of the risk-based numerator" are not included or discussed).

BEFCU has two concerns about the removal NCUSIF deposit, Goodwill, and Other intangible assets from the numerator:

- The NCUSIF deposit is cash; as such, it is an asset and should be included in the numerator, not excluded. Perhaps more troubling and confusing, is the assignment of a zero percent risk weighting to this "asset"; such an assignment recognizes that it is an asset and it has no risk (Section 702.104(c)(2)).
- Goodwill and Other intangible assets are assets a credit union holds based decisions that followed NCUA rules; to remove these assets is to change the rules. This is unfair to those credit unions who built their balance sheets, plans, and strategies based on rules the NCUA promulgated.

  This type of change is reminiscent of how goodwill was treated by the savings and loan (S&L) regulators in the 1980s; when goodwill was the only viable way to merge S&Ls merge in order to keep the industry afloat, S&L regulators urged its use. When the economy improved, the rules were changed. It punished S&Ls who unwittingly did what the regulators wanted—it put a number of the surviving S&Ls out of business.

  Care must be taken not to undo what good has been accomplished by credit unions that have followed the NCUA's rules.

Section 702.104(c): Total Risk-Weighted Assets

Perplexing, confusing, byzantine, illusory, inexplicable, and ineffectual are but a few of the descriptors used by those who helped BEFCU review this section. Adding to the rather bizarre

risk weighting scheme, there is no determinable (or proffered) explanation from the NCUA—just assigned weights.

Examining the various risk-weighted categories reveals several areas that should be reevaluated and explanation provided as to “how” and “why” the risk weights were determined and assigned. Also, consistency seems to be lacking in the assignment of risk weights.

Understanding the NCUA’s perspective, methodology, and application helps credit unions employ strategies that maximize their balance sheets and profitability while meeting NCUA requirements.

Risk Weight Categories

Category 2

- Residential mortgages guaranteed by the federal government through FHA or VA: 20% risk weight

  This item should carry a zero percent risk weighting; FHA or VA loans are guaranteed by the US government. Any weighting other than zero percent suggests the US government will not meet its “guarantee” obligation—which is simply absurd.

  If the NCUA wants a risk weight for these loans, that risk weight should only be required if the loan has to be repurchased by the credit union (a repurchase says the loan did not meet the standards required and as such could be subject to delinquency and default—which is truly a risk).

- Loan guaranteed 75% or more by the SBA, US Department of Agriculture, of other US Government Agency

  If a loan in this category has a 100% guarantee from any of those listed, the loan should have a zero percent risk weighting (i.e., the department or agencies guaranteeing these loans are the US government). Anything less than a 100% guarantee should carry some risk weighting; the 20% risk weighting may not be sufficient for the type of loans listed.

Category 5

- Loans held for sale: 100% risk weight

  Mortgage and other loans with purchase contracts or purchase commitments only should carry a zero percent risk weighting, at least until the end of the contract or commitment date. If a loan with a purchase contract or purchase commitment is not sold by the contract date, the loan should be considered a portfolio loan and subject to the risk weighting for loans in portfolio.

  Assigning a high risk weighting to contractually sold or committed for sale loans may lead to credit unions selling loans between NCUA reporting periods. Credit unions will continue to carry out these apparently high risk operations (i.e., as the risk weighting defines them) without NCUA oversight. A more rational risk weighting is needed for loans with purchase contracts or purchase commitments.

- Other real estate-secured loans less than or equal to 10% of assets: 100% risk weight

The percentage for this category should be the same as MBLs (which are allowed up to 15% of assets). Other real estate-secured loans do not have more risk, and certainly could have less risk, than MBLs. Yet, based on this rule, credit unions can hold more MBLs at a lower risk weighting than other real estate-secured loans. Notably, while credit unions certainly have more experience with real estate loans than MBLs, the percentage allocation says otherwise.

Category 7

- The total amount of investments with a weighted-average life of greater than five years, but less than or equal to ten years: 150% risk weight

  While investments greater than a five year weighted-average life are risky, such risk is greatly tempered when the US government stands behind the investment—such as the case with Fannie Mae, Freddie Mac and Ginne Mae current issue securities.

  The real risk with such securities is interest rate risk. However, that risk is no greater than fixed rate long term first mortgage loans in portfolio. In fact, the case can be made that Fannie Mae, Freddie Mac and Ginne Mae current issue securities have less risk than fixed rate long term first mortgage loans in portfolio because they can be sold instantly—portfolio loans cannot!

  Fannie Mae, Freddie Mac and Ginne Mae current issue securities should be included with a credit union's first mortgage loans held in portfolio: first mortgage loans and Fannie Mae, Freddie Mac and Ginne Mae current issue securities should be considered interchangeable and treated in aggregate, not separately.

  Thus, for risk weighting, a credit union's first mortgage loan portfolio plus Fannie Mae, Freddie Mac and Ginne Mae current issue securities should be combined and receive a 50% risk weight when the total of these two asset classes are equal to or less than 25% of the credit union's total assets. Any combination over 25% of assets for these two asset classes should then be subject to the same risk weights as provided for current and non-delinquent first mortgage real estate loans over 25% of the credit union's total assets.

Category 9

- The total value of mortgage servicing assets: 250% risk weight

  The risk weighting for this class of assets communicates a message to credit unions: do not sell loans or if you do sell loans do not value the servicing rights to the loans sold (a GAAP requirement).

  Either way, this is an irresponsible approach to balance sheet management, member service, liquidity administration, and first mortgage lending.

  In addition, the high risk weighting punishes those credit unions that have followed the rules for years; now, they must pay an irrational price (i.e., not a market set price) for their good management.

Problematically (and in the conservative manner of credit unions), the high risk weighting could lead many credit unions to sell their mortgage servicing rights. This, in turn may create an outcry from members who thought they would be serviced by their credit union (especially for loans sold to Fannie Mae or Freddie Mac). The member must be considered; it is unfair to the credit unions and to members to ignore what will reasonably happen. A reduction in the risk weighting is needed.

Finally, selling loans allows credit unions to avoid long term interest rate risk; the high risk weighting assigned places that risk right back on the balance sheet.

Section 702.105: Individual Minimum Capital Requirements

This rule is chilling. The ability of just one person to determine a credit union's net worth requirement, despite the NCUA's attempt to lay out how the rule is supposed to work, is quite intimidating—hopefully, that is not what the NCUA wants.

If this rules stands, it must have a due process methodology; it should not be governed by just a single person—particularly, when relations between the parties may be less than amicable. The ombudsman is not the answer; the methodology must be fair and open. A more prudent approach would be one that allows a hearing before a NCUA panel, which may include a supervisory examiner along with at least two other NCUA administrators not directly involved in Supervision.

Net worth is precious, earned, and subject to non-controllable influences (e.g., falling home prices or a locally bad economy); as such, net worth should not become a tool of manipulation or influence.

Finally, and most importantly, the NCUA has sufficient powers to obtain a credit union's compliance with its requirements. Those powers are not arbitrary and they have a well-established history of working: documents of record, letters of understanding, consent orders, and cease and desist orders.

BEFCU wants to thank the NCUA for the opportunity to respond to its proposal.

BEFCU also wants to thank the NCUA for its careful and thoughtful consideration of this and other responses to its proposal.

Sincerely,

Edward V. Casanova

Ed Casanova
Chief Executive Officer
Bourns Employees Federal Credit Union