CREDIT UNION of America

May 28, 2014

Via email: regcomments@ncua.gov

Mr. Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
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Subject: Prompt Corrective Action Risk-Based Capital

I am writing on behalf of Credit Union of America (CUA), which serves the communities in and around Wichita, Kansas and Great Bend, Kansas. We have more than 55,500 members and $564 million in assets. CUA appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposed rule, Prompt Corrective Action - Risk-Based Capital.

Summary and General Comments

The NCUA has characterized this proposed regulation as relatively benign with only minor and scattered impact on credit unions. It is disturbing and revealing that the NCUA does not perceive the significant adverse impacts of the regulation as proposed. We are not opposed to basic concepts of risk-based capital, but this is a deeply flawed proposal that demands we oppose a number of provisions in NCUA's proposed regulation. This proposal would have substantial adverse impact on an industry that has shown responsible constraint and commendable risk management. There is a significant disconnect between the NCUA's comprehension of the impact of this proposal, versus the real and probable impact.

Proposed weightings are in some cases too high, and include inappropriate weight escalations. The proposal attempts to stitch together credit risk, concentration risk, and interest-rate risk into one system of evaluating risk, with a poor result. Attempting to incorporate interest-rate risk while looking only at the asset portion of the balance sheet and ignoring liability structures that mitigate interest-rate risk is a fundamental deficiency. The proposal would inhibit future credit union growth in key services to members, such as

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mortgage and business loan, and create competitive disadvantages in comparison to banks who would be permitted to make the same loans with lower risk weightings. Banking has been subject to risk-based capital, yet that did little to avoid the financial and banking crisis of 2008 to 2013, so the validity of risk-based capital seems like a concept we've all agreed to pretend will make the financial system "safer."

Key Ways in Which CUA and Our Members Would Be Affected by the Proposal

1. By applying unnecessarily high and escalating risk weights, this proposal would result in reducing our ability to provide mortgage financing and business loans for members in our communities and intentionally put us at a competitive disadvantage relative to a bank making the same loans.
2. Our credit union is strongly capitalized, with just over a $30 million buffer above the current "Well Capitalized" threshold. Under the proposal, we would retain the "Well Capitalized" category, yet in order to retain the same amount of buffer we would need to grow net worth by approximately $4.3 million. This is a hidden tax of the proposal, and could require us to increase income by charging members more fees or making loan and savings rates less attractive.
3. We are a part-owner in a mortgage servicing CUSO that helps us better serve our members' needs for escrow and related services. With a $400,000 initial investment, the book value of the CUSO has grown to over $4,000,000. The 250% proposed weighting punishes the success of this service organization.

Necessity of This Proposal

We are not entirely opposed to the concept of RBC, but risk-based capital has been applied to a greater extent in the banking industry and did not prove effective in avoiding the 2008 banking crisis. If credit unions are to be saddled with a complex new capital regulation, it is appropriate to do a little back-testing to determine how effective it would have been in detecting credit unions that failed. According to a CUNA economist who related results of their testing, the proposed regulation would only have succeeded in catching eight of the top 200 credit union failures. This dismal effectiveness of the proposed regulation demonstrates that this proposed regulation is incapable of achieving the purported results. Unless we are in the business of regulation for regulations' sake, such a deficient regulation should not be imposed.

A comparative review of bank versus credit union insurance fund losses and reserve levels, beginning with the double-digit inflation crisis in 1990, reveals that credit unions have experienced only a small fraction of the volatility of the banking insurance fund. Average annual losses per $1,000 of insured deposits over that span from 1990 to 2012 were $0.18 for the NCUSIF, while for the FDIC losses were five time higher, at $0.93. This calls into question the need for a complicated risk-based capital rule for credit unions.

NCUA Authority to Impose Higher Capital Requirements

We believe this portion of the proposal is extra-legal and goes beyond the NCUA's legal authority. Problems of excessive risk taking, which have been a scattered and tiny minority of cases, should be dealt with through the examination process rather than imposing unnecessarily complex and higher capital for the entire credit union industry. We object to this provision on several grounds:

1. The NCUA believes its judgment is reliably and consistently superior to the risk management experience and knowledge by the Board and management.
2. The absence of standards for application of this provision sets the stage for arbitrariness between credit unions and between examiners, and the inability for a credit union to know it is meeting capital requirements that can be arbitrarily increased without warning.

Member Business Loan Risk Weightings

There are three reasons for objection to the proposed MBL risk weightings:

1. The proposed weighting is too high relative to the long-term historical loss experience of credit unions.
2. There is no justification for escalating the weighting as MBLs increase to a greater proportion on the balance sheet. Long-term loss data reveals that CUs have experienced far lower historical losses than banks, and credit union loss rates have actually declined as the proportion of MBLs increased, undermining the proposed escalation of risk weighting. While the NCUA can point to several exceptions, those outliers should be better addressed in the examination process.
3. The proposed weightings are greater than for the same loans held by a bank, putting credit unions at a competitive disadvantage.

Mortgage Loan Weightings

The proposal would result in reducing our ability to provide mortgage financing for members in our communities and intentionally put us at a competitive disadvantage in relation to a bank making the same loan. Our credit union was ranked 5th in market share for new mortgages in our community during 2013. Our long-term loss ratio on mortgage lending has been 0.052%, even during the worst of the 2008-2013 economic downturn. This solidly demonstrates our ability to effectively underwrite these types of loans even as their proportion and balances have grown. We currently have about 16% of assets in 1st Mortgage RE loans, subject to the proposed weighting of 0.50 which is already ten times higher than our actual loss experience. However, we anticipate continuing to grow and meet mortgage loan needs of our members and could become subject to escalating risk weights of 0.75 or even 1.00. This would create an obstacle and dis-incentive to provide increasing mortgage service to members in our community. Further, the Basel III proposal for small banks only applies a 0.50 weight for these same mortgages, regardless of concentration. The NCUA's proposal would impose risk weights up to two times higher than for banks for first mortgages. The proposed weight would represent approximately twenty times higher than our historical loss rate on these loans, with no justification for the weighting or for the significant competitive disadvantage, relative to banks, that the NCUA would intentionally create with their proposal. Further, if escalating risk weights have been proposed to account for interest-rate risk, then another deep deficiency comes into play because the NCUA violates a fundamental concept of interest rate risk by entirely ignoring the liability structure of the balance sheet.

Long-term Investment Weightings

The proposed weightings are flawed in two ways:

1. It is illogical to assign a zero risk-weighting to U.S. Treasuries, regardless of maturity, while imposing high and escalating risk weightings to other types of government agency securities based on weighted average lives. If the NCUA is integrating interest-rate risk into this proposal, it is illogical that a 30-year Treasury would receive a zero risk weighting while agency-issued mortgage-backed securities bear risk weightings of 75% even with a 3 to 5 year WAL, escalating to a risk weighting of 150% for WALs of 5 to 10 years, and to a whopping 200% weighting for WALs over 10 years.

2. The proposed weightings are far higher than the Basel III proposal for small banks, putting credit unions at a competitive and an earnings disadvantage. Bank risk weightings of 20%, regardless of maturity, are a fraction of the punitive weightings proposed.

Cap on Including the Allowance for Loan Loss as Capital

FASB is preparing to change the standards for the Allowance for Loan Loss methodology from the current incurred loss model to an expected loss model. This change is expected to increase credit union Allowance reserves significantly, with estimates ranging from 30% to 100% increases. Especially because the Allowance balance will cover losses expected for multiple years in the future, CUA believes a greater portion than proposed should count towards credit union capital. Since the Allowance for Loan Loss account exists specifically to absorb credit losses, we believe the entire Allowance should be included.

Exclusion of Goodwill from the calculation of the RBC numerator

While the exclusion makes a certain sense due to its intangible nature, we note that such exclusion can contribute to making mergers less appealing for the surviving credit union. When the NCUA is seeking a partner to assume a troubled credit union, dilution of capital is often a key consideration for the surviving credit union. Treating Goodwill in the proposed manner could thus result in greater difficulty attracting merger partners, and in marginally greater losses to the NCUSIF.

NCUA Authority to Restrict Dividend Payments

Our concern is over the unintended consequences of a restriction. While regulations require credit unions to disclose that dividends, even on share certificates, are not contractually guaranteed, the enforcement of a dividend restriction on certificates could lead to a volume of early withdrawals. The challenge may be even more pronounced for non-maturity deposits, since a restriction of dividend payments can trigger substantial loss of liquidity. These vulnerabilities will be aggravated in a rising rate environment. And even though the proposal ignores the impact of balance sheet liabilities in mitigating interest-rate risk, we note the reality that loss of certain types of credit union certificates and deposits could have another unintended consequence of heightening the interest-rate risk of the affected credit union.

NCUA's Proposed Implementation Time Line

We believe the proposed time line is too short, and that a 3-year time line should be permitted for credit unions to appropriately plan for and execute the greater profitability that will be required in order to boost capital through earnings. We recognize that "some" improvement in a credit union's RBNW ratio can be achieved through realignment of assets on the balance sheet, but even that can require more time than proposed to execute, particularly since actions such as shortening the life of the investment portfolio or reducing mortgage and business loans outstanding can reduce the credit union's current level of income and capacity to add to capital.

Complexity

The proposal is immensely complex, and a far simpler risk-based system should be developed in its place, if at all. With 16 accounts in the numerator of the RBC ratio, the different options for total assets, and the 50 or so asset risk categories, there are about 3,200 potential combinations of variables, and many will change daily. Loss of liquidity is what has typically doomed failing banks and credit unions, not a lack of capital. Such a complex approach to risk-based capital should be vastly simplified and rationalized.

Conclusion

Thank you for the opportunity to comment on this proposed rule, and for considering our views on risk based capital requirements. If you have questions or want to request clarification regarding our comments, please feel free to contact me at 316-265-3272 ext. 140 or via email to PaulM@cuofamerica.com.

Sincerely,

Paul Meissner

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