BayPort Credit Union
3711 Huntington Ave. Newport News, VA 23607 757.928.8850 www.bayportcu.org

Gerard Poliquin, May 25, 2014
Secretary of the Board
National Credit union Administration
1775 Duke Street
Alexandria, VA 22314-3428

VIA Email: regcomments@ncua.gov

Reference: Comment to the Proposed Prompt Corrective Action – Risk-Based Capital Regulation

Dear Mr. Poliquin:

BayPort Credit Union is a $1.5 billion credit union located in Newport News, Virginia. We provide the following comment letter regarding the NCUA's recently proposed risk-based capital rule.

Historical Perspective of the Statutory Net Worth Amount

The statutory net worth requirement for well-capitalized credit unions at 7% was not set by empirical studies but rather was a negotiated term in the passage of the Credit Union Membership Access Act. Bankers who have a lower net worth requirement wanted to set a high net worth requirement for credit unions to slow the growth of credit unions. NCUA is now proposing to build upon that artificially high net worth requirement that will only serve to enhance the banking industry's goal of impeding the growth of credit unions for competitive reasons. We do not object to additional capital requirements for some credit unions if justified by higher risks, but the risk levels should be established with this historical perspective.

We note that, while perhaps imperfect and indeed "one size fits all" in its approach, the current 7% net worth requirement was sufficient to sustain the credit union industry through the recent financial crisis, and credit unions did not require a taxpayer bailout. A few quick comparisons are below: (Source: CUNA research of FDIC and NCUA)

- Credit Unions and their regulators have ensured responsible lending. From 2007 to 2013 Credit Unions averaged a .90% loss ratio vs. the Banks 1.62% Since the start of the downturn in 2008 there have been 489 bank failures vs 136 credit union failures.

- Between 2007 and 2012 losses to the NCUSIF were one-tenth of the amount of the losses to the FDIC for the same time period.

These current results seem to indicate that the change in the capital system may not be a significant help and as with all changes in regulations there are many unintended consequences. If the proposal is to be implemented we would have several general comments to be considered for any final regulation.

Comments on Risk Weighting

Several of the risk weightings under the Proposed Rule appear to be arbitrary. Under the Proposed Rule, credit union risk weights would be higher than that of banks using the Basel III model, requiring credit unions to hold more capital than banks for the same assets. Unlike Basel III, the Proposed Rule forces escalating capital requirements based on the maturity of investments and concentrations of asset classes for mortgages and member business loans. As a comparison, Basel III has an across the board 50% risk weight on first mortgages. While Credit Unions' have had historically lower loss rates, the Proposed Rule would increase that risk weight arbitrarily up to as high as 100% based on concentrations. Regarding Member Business Loans, CUNA research has also shown that higher concentrations of Business Loan assets have **NOT** correlated with increased historical losses. While we agree that risk weighting is a part of prudent asset liability management we question the effectiveness in attempting to apply this in the capital context which ignores the offsetting liabilities and other interest rate risk management techniques. This is a major concern as it would place additional competitive pricing disadvantages on Credit Unions and encourage a less competitive marketplace to consumers.

The following are specific risk weightings comments and recommendations:

Cash Held at the Federal Reserve

BayPort and many in the industry have been holding larger amounts of cash at the Federal Reserve as an alternative to short term investments and as a source of liquidity should there be an increase in the utilization rate on unfunded lines of credit or an outflow of noncore deposits being parked in the balance sheet in this historically low rate environment. Under the Proposed Rule, cash balances being held at the Federal Reserve are given a 20% risk weighting. 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 a cash balance at the Federal Reserve. Under Basel III, central bank reserves are deemed to be highly liquid assets during a time of stress and carry a 0% risk weighting.

We conclude that is reasonable and prudent that cash balances at the Federal Reserve be given a 0% risk weighting in the final version of the Rule.

Investments

Under the Proposed Rule, investment risk weightings for credit unions are significantly higher than that of banks. The NCUA risk weights appear to be punitive and somewhat inconsistent when compared to banks thus putting credit unions at a disadvantage. All Treasury securities and those securities guaranteed by the NCUA or FDIC carry a 0% risk weight, no matter what the maturity. Other Agency backed securities with no credit risk, such as FMNA and Freddie Mac, are risk weighted based on weighted average life time buckets. Investments with weighted average lives greater than 5 years are given punitive risk weights of 150% for 5 to 10 year average lives and 200% for average lives greater than 10 years. This compares to 20% risk weightings for similar securities in the banking model. In addition, a 30 year whole loan mortgage on BayPort's balance sheet would carry a 50% risk weighting while securitizing the same loan into a 30 year FNMA security, with enhanced liquidity, would carry a 150% risk weighting.

The final version of the Rule should more closely mirror bank risk weightings for investments so as not to create such a competitive disadvantage.

Real Estate Loans

Under the Proposed Rule, no distinction is made on the risk weightings assigned to mortgage loans of various maturity and repricing terms. A 30 year fixed rate mortgage gets the same risk weight as a 1 year adjustable rate mortgage and a 30 year fixed rate home equity loan gets the same risk weight as a variable rate home equity line of credit. BayPort consistently manages its interest rate risk by selling much of it 30 year mortgages and using a unique three year ARM product that has been very popular with our members and has stood the test of a deep protracted recession with a very low default rate. In addition BayPort utilizes various Mortgage Equity products with variable and shorter term amortizations to further mitigate risk. As a result of managing this risk, BayPort's balance sheet is better positioned for a rising rate environment. Under the Proposed Rule, there would be no difference between BayPort's capital requirement for its diverse mortgage portfolio and the capital requirements for a credit union that holds all 30 year mortgages in the balance sheet.

BayPort believes that the capital requirement for adjustable rate mortgages and shorter maturity fixed rate mortgage loans should be lowered in the final version of the Rule to fairly take into consideration the reduced risk associated with these adjustable and shorter term mortgage loan products.

Member Business Loans

The NCUA Proposed Rule references the OIG Capping Report on Material Loss Reviews (Nov. 23, 2010) in support of subjecting a Credit Union's Member Business Loan portfolio to concentration-based tiered risk weights. A close inspection of Chart G; MLR Issue: Member

Business Lending shows that the issues identified in the report point to a failure in enforcement of existing NCUA regulations. 5 of the 7 Credit Unions discussed in the report were cited for violating NCUA MBL limits, 2 were cited for having inadequate MBL policies. This seems to have less to do with Business Lending and more to do with poor oversight. Basing the proposal for concentration-based tiered risk weights on the findings in this report ignore the vast number of credit unions making sound, prudent business lending decisions supporting small businesses in the markets we serve. The bias in favor of consumer loans that this Proposed Rule creates is also problematic. It seems counter-intuitive to risk-weight a delinquent consumer mortgage loan and a performing business loan in the same category. The fact that unsecured consumer loans receive a lower risk rating than secured business loans may force credit unions to increase production in potentially lesser quality consumer loans in an effort to preserve capital.

The final rule should remove portions of the Proposed Rule that apply higher risk weights to member business loans based on a percentage of the credit union's assets in that category.

CUSOs

BayPort has been actively involved with operational, service and insurance CUSOs over the years. The risk, as sole or part owner~~s~~ of these CUSOs, is generally limited to the amount of our investment. In addition, NCUA already limits a credit union's investment in CUSOs, under NCUA Rule 712.4, so it makes no sense to impose a 250% risk weighting on CUSO investments. The value of CUSOs has proven time and time again to be beneficial to credit unions and far outweighs the few that have experienced losses. CUSO's are often used as a way to share costs and provide related services to our members. In looking at their risks an important item to consider is that they actually offer a diversification of risks away from the interest rate risk and traditional fee income generators in the credit union industry. In the case of sharing costs, they offer the opportunity to improve earnings and build capital. It is hard to understand the rationale in assigning risk weightings of 150% and 100% respectively for delinquent consumer loans over sixty days and delinquent first lien mortgage loans, while assigning a 250% risk weighting to CUSOs.

BayPort believes that CUSO investment should be risk weighted at no more than 100%.

Change of Risk Based Capital Requirements by Examiner Discretion

Prompt Correction Action (PCA) regulations, in general, provide clear rules by which credit unions can operate to avoid prompt corrective action by the regulator. It is essential that credit unions understand clearly what their capital and net worth expectations will be. Section 702.105(c) of the proposed regulation grants arbitrary, subjective authority to examiners to increase, not decrease, minimum capital requirements. This discretion could lead to unfair and inconsistent interpretation and application of the Rule and will lead to mistrust between credit unions and the NCUA. If this provision were allowed to stand, then there is no need for much of the remaining sections of this regulation. In addition, 702.105(c) completely ignores the role of the State regulatory body with respect to state-chartered credit unions. Section 702.110(c) states that there shall be consultation regarding discretionary supervisory action taken under several sections of the Proposed Rule -section 702.105(c) is not one of those sections.

BayPort believes that this section should be eliminated from the final regulation

Risk Based Capital Numerator

Goodwill

In recent history the credit union industry has been experiencing a decline in the total number of credit unions due to mergers. These mergers are often for specific business purposes but are also at the request of regulators who are seeking to reduce the capital loss risk of a declining credit union. This proposal to eliminate goodwill, particularly for large asset sized credit unions, would take away part of the incentives and willingness of the successor credit union in the merger. Additionally, any decline in the value of goodwill will be adjusted during the annual review of goodwill for impairment. Facilitating mergers is one of the best tools to protect the credit union insurance fund as unhealthy credit unions are combined to other credit unions while minimizing member disruptions.

BayPort believes that the final regulation should allow Goodwill to be included in the Risk-Based Capital Numerator.

Allowance for Loan Losses

The allowance for loan losses serves as a reserve against expected loan losses and would seem to be a valid addition to the numerator regardless of the percentage of risk assets. In addition, the FASB has proposed standards which will likely increase normal reserves by an estimated 30% to 100% at some credit unions.

BayPort believes that there should be no restriction in the amount of the allowance for loan loss included in the Risk Based Capital Numerator.

Conclusion

BayPort consistently ranks as one of the strongest capitalized credit unions in the country. The current credit union capital requirements are already considerably higher than banks. The arbitrary application of risk weightings in the proposed rule are punitive to BayPort and other credit unions. The proposed rule, as currently written, will inhibit credit union growth and discourage expansion strategies thus negatively impacting service to members and makes credit unions less competitive with banks and other financial institution. Even worse, this proposed rule may force many credit unions to convert to a bank charter as most would be better off using Basel III as a bank, rather than the Proposed Rule as a credit union. This would severely put the credit union industry at risk and remove additional competitors that bring value to the consumer.

Thank you for the opportunity to comment, we appreciate your attention to our concerns. Please feel free to contact me with any questions you may have regarding our comments.

Very truly yours,

George R. Dudley, Jr.
President/CEO

cc: Deborah Matz, Chairman
Michael Fryzel, Board Member
Richard Metsger, Board Member