STATE OF CONNECTICUT
DEPARTMENT OF BANKING
260 CONSTITUTION PLAZA • HARTFORD, CT 06103-1800

Howard F. Pitkin
Commissioner

May 28, 2014

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

Via e-mail to: regcomments@ncua.gov

Re: Connecticut Department of Banking – Comments on Proposed Rule: PCA – Risk-Based Capital

Dear Mr. Poliquin:

The State of Connecticut Department of Banking ("CTDOB") appreciates the opportunity to provide comment on the National Credit Union Administration's ("NCUA") proposed rule ("Proposed Rule") regarding prompt corrective action/risk-based capital published in Volume 79, No. 39 of the Federal Register on February 27, 2014 that seeks to amend 12 CFR Parts 700, 701, 702, 703, 713, 723, and 747. The CTDOB supports the comments submitted by NASCUS and would highlight the following comments regarding (1) the asset size threshold and implementation period, (2) inclusion of credit risk in risk-weighting calculations, (3) practical consequences of specific parameters of the Proposed Rule, and (4) the risk weight proposed for cash investment in credit union service organizations ("CUSOs").

First, the CTDOB recommends raising the threshold for applicability of the rule to credit unions with $250 million or greater in assets. The majority of credit unions below $250 million generally have simplistic balance sheets and the CTDOB believes there would be little value in going through the time consuming process of risk-weighting their balance sheets. Furthermore, this threshold level is more consistent with recently issued NCUA rules that recognize the complexity and degree of risk in credit unions with assets over $250 million. Specifically, the NCUA recently limited its liquidity and funding and derivatives rules to credit unions over $250 million.

In addition to raising the threshold, the CTDOB recommends lengthening the implementation period and gradually phasing in the Proposed Rule over at least a 36-month period to allow credit unions sufficient time to make any necessary adjustments to their balance sheets, policies, and practices in a meaningful and well thought out manner. The CTDOB proposes that credit unions with over $500 million in assets be subject to the criteria at 36 months, and those between $250 million and $500 million should have 60 months for implementation.

Second, the CTDOB believes that the Proposed Rule does not adequately account for credit risk. The "Summary" of the Proposed Rule states that "[the] proposed risk-based capital requirements would be more consistent with . . . the regulatory risk-based capital measures used by the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve, and Office of the Comptroller of Currency (Other Federal Banking Regulatory Agencies)." However, risk-based capital for banks is focused primarily on credit risk, while the Proposed Rule seems to focus on interest rate and concentration risks. For example, the Proposed Rule calls for the risk-weighting of investments based on weighted average life ("WAL"). The Other Federal Banking Regulatory Agencies ("OFBRA") risk weight investments by type, as different investments will have different risk profiles. For example, a security issued by a state or local government and held by a bank would receive a 20% risk weight and an interest-only strip would receive a 100% risk weight, effectively capturing inherent credit risk in these types of investments. Under the Proposed Rule, an interest only strip with a WAL of 2 years would receive a 50% risk weight, while a 62 month WAL security issued by a local or state government would receive a 150% risk weight. Accounting for investments in this way under the Proposed Rule captures interest rate risk in a rising rate environment, but ignores all aspects of credit risk. If the NCUA wishes to capture the interest rate risk inherent in investments, a matrix which includes both interest rate and credit risk could be utilized.

Third, the CTDOB believes the risk weighting for residential real estate loans and requirement to hold capital for the full balance of limited recourse loans in the Proposed Rule would result in unintended consequences. All current first mortgage residential real estate loans are risk weighted 50% by the OFBRA. Under the Proposed Rule, however, residential real estate loans would be placed in weight buckets based on the amount of total residential real estate loans held by the credit union. While the CTDOB does recognize the possibility of concentration and interest rate risk with a large residential real estate portfolio, assuming the same underwriting standards are utilized for all residential loans, the first dollar lent would have no more or less risk than the last dollar lent. This provision penalizes well-run institutions that have chosen to specialize in real estate lending and will ultimately harm the consumer by limiting the availability of this type of credit.

Moreover, the OFBRA requires risk-based capital be maintained at a level not to exceed the maximum amount of recourse for which the institution is contractually liable under the recourse agreement. The Proposed Rule, on the other hand, requires the full balance of loans sold with limited recourse to be used in calculating risk based capital. The sale of loans with limited recourse provides credit unions with a valuable option in managing liquidity and interest rate risk, while allowing the credit union to serve the needs of its customers and community. By requiring a credit union to hold capital for the full balance of loans sold with limited recourse, the Proposed Rule not only penalizes the credit union, but also may serve to limit the availability of credit in the community.

Finally, the CTDOB believes that the 250% risk weight assigned to cash investment in CUSOs is arbitrary and excessive. Assigning such a high risk weight is arbitrary because the NCUA has not identified why it believes that a credit union will lose more than its initial cash investment in a CUSO. Furthermore, the risk weight does not differentiate between types of activities conducted by CUSOs, the risk inherent in the various activities, or the assets held by the CUSO, but instead paints all CUSOs with the same punitive brush. Assigning such a high risk weight is excessive because CUSOs are already (or will be) subject to regulatory oversight. In Connecticut, the CTDOB authorizes the formation of and regularly examines CUSOs. Any supervisory concerns are addressed in the normal course of the examination process. On the federal level, NCUA recently finalized a rule amending 12 CFR Parts 712 and 741 that expands NCUA oversight over CUSOs "to . . . address certain safety and soundness concerns" by, among other things, requiring CUSOs to report information to the NCUA based on the complexity or risk level of the CUSO's activities. See 78 FR 72538 (Dec. 3, 2013). Collection of this data will allow regulators, including the NCUA, to monitor CUSOs' activities and analyze the risk associated with investment in CUSOs.

We appreciate the opportunity to comment on the NCUA's Proposed Rule regarding prompt corrective action/risk-based capital.

Very truly yours,

HOWARD F. PITKIN
BANKING COMMISSIONER

cc: The Honorable Debbi Matz, NCUA Chairman
The Honorable Michael E. Fryzel, NCUA Board Member
The Honorable Rick Metsger, NCUA Board Member
The Honorable Richard Blumenthal
The Honorable Christopher Murphy
The Honorable John Larson
The Honorable Joe Courtney
The Honorable Rosa DeLauro
The Honorable Jim Himes
The Honorable Elizabeth Esty
The Honorable Carlo Leone
The Honorable William Tong
The Honorable Art Linares
The Honorable Mike Alberts
Mary Martha Fortney, President/CEO NASCUS