RB Premier Services LLC

Investments ★ Insurance ★ Mortgage ★ Realty ★ Title ★ Appraisal

May 28, 2014

The Honorable Debbie Matz
The Honorable Mike Fryzel
The Honorable Richard Metsger
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: 3133-AD77 – Prompt Corrective Action – Risked Based Capital

Dear NCUA,

On behalf of RB Premier Services LLC, a wholly owned CUSO of Randolph Brooks Federal Credit Union, I am providing the following comment letter regarding NCUA's proposed risk based capital rule. I very much appreciate the opportunity to provide my thoughts on this very far reaching regulatory proposal and hope that you will consider some of the constructive comments you receive on the proposal.

The first concern I have with the proposal is the risk weighting of CUSO investments. The 250% risk weighting seems punitive and arbitrary. The single risk weighting for all CUSO investments doesn't consider the nature and operational environment of the CUSO. Does a CUSO that is set up for the purpose of sharing IT resources pose the same risk as a CUSO set up to originate business loans? Most CUSO's are not involved in high risk activities and shouldn't warrant a 250% risk weighting. NCUA has already identified this difference in risk exposure in their recently finalized CUSO rules where there is expanded reporting to NCUA for CUSO's doing certain activities that are considered higher risk. When comparing the proposed rule to the Basel III requirements of banks, the 250% risk weight appears punitive when a bank can risk weight a non-significant equity investment at 100%. Since all CUSO investments are limited to 1% of capital and surplus of the credit union, they are clearly considered a non-significant investment. In substance, a bank could have a non-public equity investment in a company that does the same things that a CUSO would do and the bank would only have a 100% risk weighting toward that investment. Is there a justifiable basis for the difference in treatment? If NCUA doesn't revise this risk weighting, it would put credit unions at a tremendous disadvantage compared to banks and would, through this regulation, start the demise of the collaborative efforts taking root in the credit union industry, as no one will want to start a collaborative CUSO operation.

Another concern I have is the adverse risk weighting for mortgage servicing assets (MSA). The 250% risk weighting will force credit unions to sell their MSA, similar to what has happened at banks with the implementation of Basel III requirements. Under Basel III, Banks also have a 250% risk weighting for this asset and because of the punitive nature of the risk weighting, they have been selling these asset types. When comparing the risk weighting of these assets to other assets, it makes you scratch your head. Would you rather have MSAs on the balance sheet or a pool of delinquent credit card loans? Since the risk weighting of delinquent credit card loans is 150%, it appears that NCUA would rather you have the delinquent loans than the MSAs. The possibility of losing the entire balance of the asset is greater with the delinquent credit card loans than the MSAs. Also, MSAs are natural hedges for a real estate portfolio, as changes in interest rates have an inverse impact on these two asset classes (as rates rise, a real estate portfolio loses value but MSAs increase in value and as rates decline, a fixed rate real estate portfolio increases in value and MSAs decrease in value.) Thus, this risk weighting seems high.

Also, having a separate risk weighting for loans held for sale at a 100% risk weighting could lead to manipulation by credit unions and a double penalty for them. Loans held for sale should not have a separate risk weighting but should carry the risk weighting based on the collateral type of the loans. If a credit union has MBLs with a risk rating of 150%, they could reduce their risk based capital requirements by deeming a certain amount of these loans as held for sale, as they would then receive a risk weighting of 100%. And, why would a vehicle portfolio that is deemed held for sale need a higher risk weighting (100% vs. 75%). Once deemed held for sale, US GAAP requires these assets to be recorded at market value. If the value of these assets have declined due to increases in market rates, proper accounting treatment would require the credit union to take the loss in the current period. Not only would they record the loss in the current period but they would get hit with a higher capital requirement for these assets, which appears to be a double penalty.

Another area of concern is the examiner discretion part of the regulation. The entire regulation, other than this area, is very precise and quantifiable by the credit union community. But in certain undefined circumstances, the examiner can raise or lower your capital requirements from the objectively calculated requirement of the regulation. This provision makes it very difficult for credit union management to plan for the future, from a capital perspective, as they do not actually know what capital level will be required by their examiner. If the examiner has the capability to change the capital required, why have such a precise regulation as to how to calculate your capital requirement? Since examiners already have tools via the CAMEL rating system to influence actions of a credit union, they should use this method of enforcement as opposed to subjectively changing an objective measure.

Also, I am curious how secured vehicle loans, both when they are current and delinquent, have the same risk weighting as unsecured loans. The loss potential on unsecured is tremendously higher than for secured vehicle loans. When an unsecured loan goes bad, you lose everything. At least with a bad vehicle loan, you recover some of the balance when you liquidate the vehicle.

Lastly, there are many areas where the treatment of items for credit unions is significantly more constraining than the Basel III requirements for banks. In additional to the areas discussed previously, one of these areas is the additional capital buffer of 2.5%. NCUA has chosen to apply the additional buffer immediately while the banks have until January 2019 to comply with the full amount of the additional buffer. What is the rationale for the difference? This immediate adverse difference could cause some credit unions to fail the risk based capital test where a similar type bank would have five years to earn the additional capital buffer. Another area is the treatment of business loans and residential loans. NCUA has chosen to add a concentration risk component to both the business loan and residential loan risk weightings that bank do not have under Basel III. This may cause credit union management teams to limit offering certain loan types to its members in the future, pushing them to banks that offer these services. These differences over time will give the banks a significant competitive advantage over credit unions. It seems like this proposed regulation, when compared to the Basel III requirements of banks, is punitive to credit unions, as most of the differences between the two regulations are detrimental to the ability of credit unions to compete. I am not aware of any area where the risk weightings of a particular asset class are more lenient for a credit union than a bank, but there are several instances where the risk weightings are more restrictive for credit unions. This treatment does seem fair.

Thank you very much for the opportunity to comment on this proposed regulation. We support the efforts of NCUA to pursue a balanced risk-based capital system that requires additional capital of truly higher risk credit unions even as it rewards those credit unions with proven risk management evident in a lower risk balance sheet. Please consider the comments received related to the proposal prior to finalizing the regulation.

Sincerely,

Robert Zearfoss
President
RB Premier Services LLC