From:	Chip Filson
To:	_Regulatory Comments
Cc:	"remetsger@ncua.gov"; Matz, Debbie; Fryzel, Michael E
Subject:	NCUA Risk-Based Capital Proposed Reg
Date:	Wednesday, May 28, 2014 3:54:49 PM

Mr. Gerard Poliquin, Secretary of the Board

National Credit Union Administration

1775 Duke Street

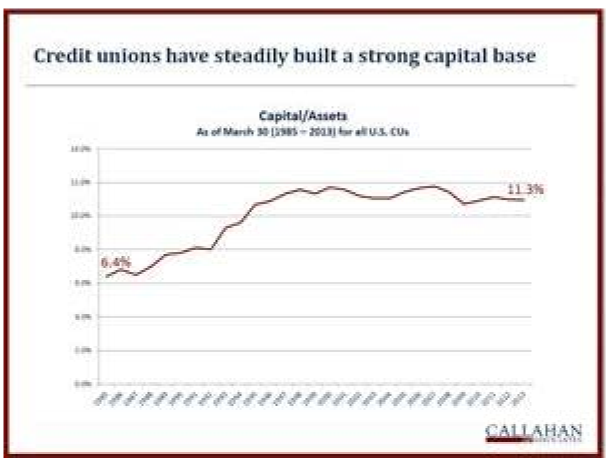
Alexandria, VA 22314

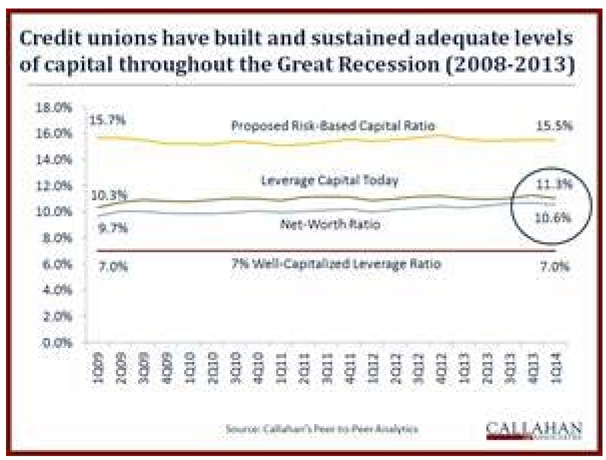
Re: comment on Risk Based Capital Rule Proposal

Credit unions, in their cooperative design, start with no financial capital. Rather their source of strength is the passion of their organizers and the connections they establish with their members. This is true at the beginning and is still the distinguishing factor in credit union soundness today.

Human Capital Creates Financial Strength

It is human capital that creates financial reserves, as managers set aside a portion of revenue to cover potential uncertainties in operations and risk assets. Credit unions have no access to external capital markets as do banks. Every active credit union today has gone from a 1%, then 2% etc. net worth ratio, to over the 7% well capitalized level. On average the credit union system has 10.6% net worth at March 30, 2014, and a $123 billion in total capital. Starting from $0 in reserves the cooperative system has created financial capital from innovation, steadfastness, and ever-learning leaders.





The Simple Cooperative Reserve-Capital Leverage Model Works

The cooperative model works, and has continued to function well in every economic or financial crisis in the U.S. for over 100 years. The capital-reserve model works because it is simple, easily to understand and is readily comparable. But more importantly it works, because boards and managers are experienced and sensitive to the variety of factors that are entailed in effective risk assessments for their institution's plan and the external circumstances of their members and communities. They have become expert at adapting their pricing, product and financial models to the needs of their members.

The hundreds of detailed comments filed about this rule from concerned managers, members and boards, reflecting their concern with a single national formula for risk assessment, demonstrate the professionalism and multi-faceted insight provided at the individual operating level by these managers and volunteer directors. A one-size-fits all rule created in Washington, can never supplant the judgment and expertise of credit union professionals and volunteer directors in their individual decisions about financial reserves.

What is even more troubling is that all models including this rule are based on assumptions. While well-intentioned, if the assumptions about risk are wrong, the rule could drag the whole industry over a cliff. For example, two of the lowest weighted risk classes in Basel II.5 were sovereign debt and mortgage backed securities-both asset classes at the core of the subsequent financial crisis.

<u>The Cooperative System's Resources</u>

One other factor in cooperative strength is the ability to work collectively for <u>system solutions</u> and safety nets that reflect their values and principles. The unique structure of the NCUSIF, in which each member contributes 1 cent of every share account into the Fund, provides a collective source of capital for financial repair when that alternative is most appropriate for a troubled credit union. The banking system has no such option.

Until 2010, the credit unions also had a uniquely funded and structured liquidity safety net combining system liquidity with access to the Treasury in times of market turmoil. For in a crisis and, as clearly borne out by events during the Great Recession, liquidity trumps capital. No rule can create liquidity. Unfortunately NCUA closed this option, which is the real foundation for stability in a panic.

<u>Risk Based Capital and banks: "An experiment that has lasted too long"</u>

Fortunately credit unions can learn from the experience of the banking regulators which have been experimenting with multiple variations of RBC since 1988.

In a September 14, 2012 analysis Thomas Hoenig, Vice Chair of the FDIC, made the following comments in a speech "Back to Basics: A Better Alternative to Basel Capital Rules."

After noting he had been involved with central banking and financial supervision his entire career, he stated in part:

The poor record of Basel I, II and II.5 is that of a system fundamentally flawed. . .it turns out that Basil capital rules protected no one: not the banks, not the public, and certainly not the FDIC. . . the complex Basel rules, hurt rather than helped the process of measurement and clarity of information.

I suggest that we not only can go back, we must . . .to a simpler alternative that takes us back to basics.

An alternative. Experience suggests that to be useful a capital rule must be simple, understandable and enforceable. The measure that best achieves these goals is the tangible equity to tangible asset ratio. It does not tier the measure into any number of refined levels. There is not a government ex-ante endorsement of risk assets or capital allocations. . .It provides a consistent and comparable measure across firms.

His conclusion: *Basel III will not improve the outcomes for the largest banks. . .nor improve the condition of small and medium sized banks. <u>It continues an experiment that has lasted too long</u>.* (Speech to the American Banker Regulatory Symposium, Washington, D.C.)

On April 8, 2014 at the FDIC board meeting the five directors unanimously agreed with this analysis. The FDIC adopted a simple leverage ratio capital rule following similar actions already taken by the OCC and the Federal Reserve Board.

Banking regulators are unanimous. The simple leverage capital ratio, the method used by cooperatives for over 100 years works; the risk based approach does not.

Why would NCUA foist on credit unions a complicated, fatally flawed approach to reserving against the unanimous judgment of the banking regulators that a simple leverage ratio is better?

Conclusion:

The rule should be withdrawn. There has been no need demonstrated. The suggested model is fundamentally flawed, and banking regulators have backed away from the concept.

If NCUA believes that there is merit to this analytical approach, then the model should be included as an option for use in examination reviews. The model could assist in providing insight from the regulator's perspective in those situations where they believe the reserving judgments of the leadership of the credit union, even if in compliance, are not well founded.

To continue this rule making process distracts the Board and leadership at NCUA from focusing on serious issues of NCUA internal management that, if corrected, could significantly contribute to enhancing the strength and unique role of the cooperative system.

The rule reflects a lack of comprehension of what makes cooperatives successful. For it would distort fundamental credit union business decisions to conform to bank-like assessments of capital-at-risk versus meeting member needs. It would reinforce perceptions across the industry that NCUA does not grasp cooperative design, is unwilling to learn from industry experience, and most fundamentally is unanswerable to those whose conduct it most affects.

America needs an independent, successful and innovative cooperative system, not another 6,300 banks. The only reference for this rule is the banking industry, which has rejected its efficacy. So should NCUA.

Sincerely

Charles W. Filson

Chairman

Callahan & Associates, Inc.