May 28, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

RE: Comments on Proposed Risk-Based Capital Regulation

Dear Mr. Poliquin:

Thank you for the opportunity to comment on NCUA's pending Risk-Based Capital Regulation. As a long-time member of the credit union community with a proven commitment to safety and soundness, Parsons Federal Credit Union certainly understands the desire of the NCUA to improve the safety and soundness of our industry. Unfortunately, having read and considered the proposed regulation, it is our strong sense that the proposal falls far short of its intended goal. In fact, given the many inconsistencies in risk-weightings, the startling omissions in approach, the built-in potential for examiner overreach, and the need for growth and relevance (as well as safety and soundness) within the credit union movement, we feel that the regulation in its current form is more likely to do harm than good.

While a risk-weighting system such as the one proposed does have the advantage of being relatively straight forward, it demands at the very least a little consistency and common sense. A zero risk-weighting for Treasuries makes no sense at all. While it could be argued that Treasuries possess no credit risk, a zero weighting for the entire class disregards the considerable interest rate risk in, say, a 10-year piece. Is the NCUA suggesting that credit unions load up on 10-year Treasuries in order to max out their RBC ratings? Where is the logic in a 50% risk-weighting for a 30-year mortgage, as compared to a 150% risk-weighting for a 6-year weighted average life MBS pool? The pool clearly contains less credit and liquidity risk, and certainly no more interest-rate risk, than the 30-year mortgage, but somehow ends up with triple the risk rating! How do 30-year fixed and 30-year ARM mortgages get treated equally? What is the rationale in lumping MBS and CMO's together for risk-weighting purposes? Or for that matter, what is the justification for treating all CMO's the same, given their incredible diversity? While NCUA's purported intent is to increase safety and soundness, it would seem from just these few examples that credit unions could easily be led to increase, not decrease, risk by using the proposed guidelines.

Beyond these and many other examples of risk-weight inconsistency are many more serious and fundamental issues involving general approach. How is it possible to conduct a rigorous, comprehensive analysis of balance sheet risk while omitting consideration of one half of the balance sheet? Liability structure matters… and it is not even mentioned! How is it possible to risk-weight real estate loans without any consideration of LTV or credit scores? How is it possible to risk-weight MBS and CMO product according to their *current* weighted average lives without any regard for their *extension* tendencies? Should credit unions be bulking up on volatile CMO product with short current lives in order to bolster their current risk evaluations? Clearly, any risk guidance which ignores such fundamental risk factors as these is destined to mislead some credit unions into thinking that they are well positioned for risk when they are not, or conversely, sounding alarm bells that lead to bad decision-making for credit unions that are in fact sufficiently prepared.

In its proposal, the NCUA states that the new "risk-based capital requirements would be more consistent with … the risk-based capital measures used by the Federal Deposit Insurance Corporation …" which raises the question, "Why copy banks?" Was their performance in the 2008 financial meltdown really worthy of emulation? Did not natural person credit unions, on the whole, perform much better than their banking kin? And if we must conform to their process, why punish the better-performing industry (credit unions) with risk-weightings (such as those for mortgage loans) which are even higher than those applied by the FDIC to banks?

And finally, after all of the other serious flaws in the proposal, there is the "elephant in the room": the Individual Minimum Capital Requirements authority, which allows an examiner to require additional risk-based capital from a credit union that already meets or exceeds NCUA's new risk-based capital threshold. While we respect the overall competence of NCUA's examiner corps, we cannot help but worry about the potential for arbitrary action by the occasional rogue examiner. If the risk-weighting system is not robust enough to capture the totality of risk to credit unions (and it clearly is not!), then maybe the proposed RBC system should be re-constituted as a trigger mechanism for additional review, as performed by a newly established echelon of examiner with special training in the area of risk and risk-management.

In conclusion, it would seem to us that if the NCUA is serious about improving its measurement and regulation of risk, it must take a more comprehensive approach. Such an approach would probably be less neat and tidy than the current proposal. It would involve a wider array of tools, and require more education and time of both examiners and credit union staff. But the pay-off would be in greater credit union flexibility, relevance and growth. And if done correctly, it would bring about far better risk management than the currently-proposed RBC regulation.

Sincerely,

Gary Pugh
Accounting Department
Parsons Federal Credit Union