May 28, 2014

Mr. Gerald Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Arlington, VA 22314-3428

Re: Comment to Proposed Prompt Corrective Action: Risk-Based Capital Rule; RIN 3133-AD77

Dear Mr. Poliquin:

Thank you for the opportunity to respond to the proposed risk-based capital rule. Landmark Credit Union is a community chartered credit union serving 234,000 members with $2.5 billion in assets.

Landmark opposes the proposed rule because it would significantly impair Landmark's ability to serve its members. Landmark is well capitalized and would remain well capitalized under the proposed rule calculation. However, as of 03/31/14 Landmark's Risk-Based Capital Ratio would be 10.55% which is only 0.05% above the proposed rule's 10.50% well capitalized threshold. This is a materially smaller cushion to be well capitalized than exists under NCUA's current risk-based capital measure. If the proposed rule is implemented Landmark may be forced to reduce lending, restrict deposit growth, and/or increase fees to members in order to build capital levels beyond what is necessary for safe and sound operation just to meet the new risk-based calculation. These actions would jeopardize Landmark's brand which has been carefully constructed and reinforced for decades, deter our members from expanding relationships with us, adversely affect our ability to compete against other financial institutions for new members, and limit our ability to benefit from economies of scale. The proposed risk-based capital rule would ultimately weaken Landmark, and the industry as a whole, not strengthen it.

Landmark has serious concerns about the risk-base capital calculation and other features of the proposed rule. Specific concerns with the proposed rule are outlined below.

<u>Interest Rate Risk</u> – Risk weights on assets that attempt to reflect interest rate risk are not in-line with bank risk based methodologies, do not fully reflect an institutions' interest rate risk, and are not internally consistent within the NCUA calculation.

Bank regulator risk based methodologies do not incorporate weight differentials based on weighted average life (WAL). This is appropriate because an institution's interest rate risk is not caused by holding any particular instrument, but how its basket of asset instruments is structured relative to its basket of funding instruments.

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The proposed rule's attempt to incorporate interest rate risk into capital requirements is problematic because it ignores the liability side of the balance sheet and only focuses on a narrow segment of assets. Penalizing institutions for certain longer term assets while not also recognizing the risk mitigation provided by longer term liabilities skews the risk assessment and results in unwarranted additional capital requirements. Additionally, not considering mitigating liabilities and only adjusting risk weights on certain investments including mortgage backed securities (MBS) could lead to increased volatility in required capital levels. Movement in interest rates and corresponding changes in prepayment speeds could easily flip a sizeable MBS portfolio back and forth between four and five year WALs resulting in material capital requirement fluctuations.

The proposed rule's attempt to factor in interest rate risk is not consistent across asset classes. Higher risk weights are assigned for some investments (i.e. MBS) based on increasing WALs but not for other investments (i.e. Treasuries). An MBS security backed by amortizing 30 year loans has less price volatility than a 30 year Treasury security. Also, there are no higher risk weights for loans with long WALs even though a 30 year MBS security will behave substantially similar to a pool of on-book 30 year mortgages. Finally, basing risk weights on WAL to reflect potential interest rate risk is not entirely accurate. WAL is a cash flow/maturity statistic not necessarily an interest sensitivity measure and the proposed rule would unfairly penalize floating rate longer WAL investments (i.e. variable rate CMOs backed by 30 year collateral).

Landmark recommends eliminating higher risk weights for any asset based solely on weighted average life.

Concentration Risk – Risk weights that increase based on percentages to total assets for mortgage loans and member business loans (MBLs) are not in-line with bank risk based methodologies, and concentration percentages for asset classes are not in and of themselves accurate measures of risk.

Bank regulator risk based methodologies do not incorporate weight differentials based on percentage of total assets for a given asset class. This is appropriate because the composition of any asset class and its inherent risk is unique to every institution.

Concentration percentages alone are not predictors of loss or sound measures of risk. An institution's risk of loss on a certain asset class is the sum of the individual instrument loss risk within that class; not an increasing function based on relative portfolio size. It is the quality of loans in a portfolio that drives risk. As a practical example, Landmark, which has very low loan loss rates on member business loans (less than 5 basis points) and mortgages (less than 25 basis points) over any time range back through the Great Recession could be unduly punished with excessive capital requirements if the proposed rule is implemented. If Landmark in the future had a mortgage portfolio totaling 25% of assets and then originates a new mortgage loan; there is no basis to believe that the new or marginal loan would have any more or less risk than any other loan in the portfolio. Accordingly, there does not appear to be a justification for increasing the risk weighting on that marginal loan.

Landmark recommends eliminating higher risk weights for any asset based solely on concentration percentages.

NCUSIF Deposit – The proposed rule excludes the NCUSIF deposit from the risk based capital calculation. This treatment implies that the deposit has no value and would be contradictory to NCUA's guidance that it should be reported as an asset rather than expensed. Landmark is concerned that if there is no regulatory value to the deposit it is more difficult to justify carrying this item as an asset on its audited financial statements. Additionally, if a credit union voluntarily liquidates the deposit is refundable which indicates there is value.

Landmark recommends that the NCUSIF deposit be included in both the numerator and denominator of any risk-based calculation.

Limitation on ALLL – The proposed rule limits the ALLL in the numerator to no more than 1.25% of risk assets. The rationale for this limitation is not clear. By assigning delinquent loans higher risk weights, but not allowing a full credit for corresponding ALLL balances appears inconsistent. ALLL balances are clearly available to cover losses and should not be limited.

Landmark recommends that the full ALLL balance be included in the numerator of any risk based capital calculation.

Excessive Risk Weights – The proposed rule includes very high risk weights for several specific asset classes which appear inappropriate for the real risk posed by these assets. Many of these impact mortgage lending and if implemented as proposed would likely force Landmark to restrict purchase, refinance, and home equity lending available to members.

> *Other Real Estate Loans* – The proposed starting risk weighting of 100% for Other Real Estate loans is too high for the risk posed by these loans. Other consumer loans and unsecured credit card loans have a risk weighting of 75% with no proposed escalation for concentration tiers. To apply a 100% to 150% risk weighting to loans that in Landmark's case are better secured and have lower historic loss rates than other consumer and credit card loans does not appear warranted and would result in excessive capital requirements. **Landmark recommends a flat 75% or lower risk weight for Other Real Estate Loans.**
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> *MSR* – Mortgage Service Rights are proposed to have a 250% risk weight. This high reserve level is punitive and ignores the benefit from this asset in an increasing rate environment. Landmark has in part built its mortgage brand on local servicing. The proposed risk weight would be a significant disincentive to retain serving on loans sold to the secondary market and potentially weaken our member relationships. Many credit unions retain servicing rights to serve their members and not to create a financial asset to be traded. This in-house strategy for holding MSRs justifies a lower risk weighting. **Landmark recommends a risk weight of no more than 100% on MSRs, if the MSRs are not held for sale.**

Loans Held For Sale – The proposed 100% risk weight for Loans Held for Sale (HFS) is significantly too high for the risk these assets present if they are covered by forward sales contracts. HFS loans that are covered by mandatory forward sales contracts are transitory on the balance sheet and represent no capital risk as they will be replaced by cash within 30 days upon sale. Imposing a 100% risk weighting will result in excess capital requirements and be a disincentive to make mortgage loans. **Landmark recommends retaining the 100% risk weight for HFS loans not covered by mandatory sales contracts, but using a 0% risk weight for HFS loans covered by mandatory sales contracts or other permissible hedging strategies.**

Corporate Perpetual Capital – The proposed 200% risk weight for perpetual capital in corporate credit unions is excessive and creates a disincentive to partner with a corporate credit union which will weaken the system. Although perpetual capital is clearly a risk asset, the proposed across the board 200% is punitive to investor credit unions that perform prudent risk management and due diligence and invest in well run well capitalized corporate credit unions. Any risk weighting above 100% on perpetual capital should be based on the capitalization level of the issuing corporate credit union. If the issuing corporate is well capitalized the risk of the investor's perpetual capital is minimal and so warrants a reasonable risk weight of 100%. However, if an issuing corporate is not well capitalized than it is appropriate for a higher risk weighting to be used. **Landmark recommends a tiered risk weighting starting at 100% for perpetual capital in a well capitalized corporate and a higher risk weight for investment in undercapitalized corporate credit unions.**

CUSOs – The proposed 250% risk weight for investments in CUSOs is excessive and would create a disincentive for credit unions to collaborate. Many smaller credit unions can only participate in essential service offerings by belonging to CUSOs due to their lack of scale or in-house expertise. The proposed excessive risk weight may have the unintended consequence of pushing small credit unions out of CUSOs, limiting their service offerings, and putting them at an even greater competitive disadvantage. **Landmark recommends a risk weight of 100% for CUSO investments and loans.**

Penalty 'Comprehensive Understanding of Asset Backed Investment' – The proposed ability for an examiner to impose a 1,250% risk weight on any asset backed investment where the credit union cannot demonstrate a comprehensive understanding is dangerous and excessive. The resulting capital requirement would exceed the carrying value of the investment. This is not reasonable. Additionally, the application of this penalty would be based on the subjective opinion of an individual examiner which would not result in uniform treatment. **Landmark recommends eliminating this penalty provision or at least moving its implementation to a supervisory level to help ensure consistency of application.**

<u>Exclusion of Goodwill</u> – Excluding goodwill from the risk-based capital calculation, but including it in the leverage or Net Worth Ratio calculation is punitive. For a credit union to maintain Goodwill on its

balance sheet it must monitor this asset for impairment. If a credit union carries goodwill and obtains an unqualified opinion audit on its financial statements this strongly supports that there is value to the reported goodwill. Accordingly, goodwill should be included in the risk based capital calculation. Goodwill on credit union financial statements is derived from mutual to mutual business combinations that would imply a greater likelihood of sustainable benefit than from a hostile for-profit acquisition. This provides the rationale for including goodwill in credit union risk-based calculations while it is excluded in Basel calculations.

Landmark recommends including goodwill in any risk-based capital calculation.

Individual Minimum Capital Requirements (IMCRs) – The proposal appears to allow individual examiners to impose higher minimum capital requirements for a broad range of reasons. Given the dramatic impact capital requirements have on institutions it is imperative that any supplemental capital requirements be applied through a clear, consistent, and visible process with an appeal mechanism.

Landmark recommends any IMCRs be imposed at the Regional Director level with a process to appeal to the NCUA Board.

Implementation Period – The proposed eighteen month implementation period is far too short to allow credit unions any meaningful opportunity to adjust their operations and reposition their balance sheet to meet new risk-based capital requirements. Given that credit unions can only increase capital through earnings and not via alternative methods, the implementation time should be longer than afforded to banks under Basel.

Landmark recommends the implementation timeframe for any material adjustments to risk-based capital requirement be at least five years.

In summary Landmark Credit Union strongly believes this rule as proposed will adversely impact our members, our company, and our industry. The issues addressed above will increase the level of capital Landmark is required to carry to be 'well capitalized' beyond what is actually needed to operate in a safe and sound manner. Landmark remained financially strong throughout the Great Recession and is prudently growing members, capital, and assets in the difficult economic environment of the current subdued recovery. We have accomplished this success while operating at the safe and sound 'well capitalized' reserve levels under existing regulations. Landmark would need to penalize our members by discouraging borrowing, negatively adjusting rates, deter savings, and/or increasing fees in order to bring our reserves up to and stay within the new proposed risk-based capital requirements.

Thank you, again, for the opportunity to comment on the proposed changes. Landmark sincerely appreciates your thoughtful consideration of how the proposed rule would negatively impact our members, and our ability to compete and prosper in the future.

Respectfully submitted,

Jay Magulski
President / CEO
Landmark Credit Union

David Powers
Chief Financial Officer
Landmark Credit Union