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Via email to: regcomments@ncua.gov

Mr. Gerard Poliquin
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Proposed Rule – Risk Based Capital

Dear Mr. Poliquin :

Shutts & Bowen LLP is pleased to have the opportunity to comment on the National Credit Union Administration ("**NCUA**") proposal to revise NCUA's current prompt corrective action ("**PCA**") rules for federally insured natural person credit unions (the "**Proposed Rule**"). According to NCUA's Release of the Proposed Rule (the "**Release**"),[1] the risk-based capital requirements contained in the Proposed Rule would be more consistent with NCUA's risk-based capital requirement for corporate credit unions and the regulatory risk-based capital measures used by the Federal Deposit Insurance Corporation ("**FDIC**"), the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency (collectively, the "**Other Agencies**"). We further understand that NCUA is considering the Proposed Rule in light of (a) the experiences of the 2007-2009 recession; (b) the publication by the Basel Committee on Banking Supervision of "A Global Regulatory Framework for More Resilient Bank and Banking Systems" in December 2010, as revised in June 2011 ("**Basel III**"); and (c) FDIC's September 2013 issuance of its Interim Final Rule (with request for comments) (the "**FDIC Interim Final Rule**").[2] We respectfully submit the following comments for NCUA's consideration in developing a final version of the Proposed Rule.

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[1] *See*, 79 F.R. 11184 (February 27, 2014), National Credit Union Administration: "Prompt Corrective Action – Risk-Based Capital."

[2] *See*, 78 F.R. 55340 (September 10, 2013), Federal Deposit Insurance Corporation: "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule."

According to the Release, NCUA believes that a goal of the new risk-based capital should be to "address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk." In this regard, the Proposed Rule attempts to address these broader risk exposures by assigning specific risk weights to delinquent loans, concentrations of member business loans ("MBLs") and real estate-secured loans, equity investments, and additional off-balance sheet exposures.

PCA systems, however, are designed to address credit risk and are not generally used to address other forms of risk to which financial institutions are exposed. Neither Basel III nor the FDIC Interim Final Rule attempts to capture interest rate risk, liquidity risk, market risk, or operational risk in its risk weightings. FDIC specifically acknowledges this in the FDIC Interim Final Rule, stating,

> The FDIC's general risk-based capital rules indicate that the capital requirements are minimum standards generally based on broad ***credit-risk considerations***. ***The risk-based capital ratios under these rules do not explicitly take account*** of the quality of individual asset portfolios or ***the range of other types of risk to which FDIC-supervised institutions may be exposed, such as interest-rate, liquidity, market, or operational risks***. (Emphasis added.)[3]

Instead, both Basel III and the FDIC Interim Final Rule anticipate that bank regulatory authorities would employ other means to measure and control risks other than credit risk. For example, Basel III creates a "liquidity coverage ratio" and a "net stable funding ratio" to address liquidity risk. In addition, the FDIC Interim Final Rule provides for a "supervisory assessment of overall capital adequacy" that,

> [takes] account of whether an FDIC-supervised institution plans appropriately to maintain an adequate level of capital given its activities and risk profile, as well as risks and other factors that can affect an FDIC-supervised institution's financial condition, including, for example, the level and severity of problem assets and its exposure to operational and interest rate risk, and significant asset concentrations. For this reason, a supervisory assessment of capital adequacy may differ significantly from conclusions that might be drawn solely from the level of an FDIC-supervised institution's regulatory capital ratios.[4]

FDIC acknowledges that risk exposures and factors other than credit risk may call for an FDIC-insured institution to increase its capital levels. However, rather than using PCA risk weightings, FDIC uses supervisory assessments to tailor an institution's required capital to its unique size, complexity, and risk profile. NCUA proposes to adopt a comparable approach (Section 702.105 of the Proposed Rule) that would authorize NCUA officials to establish an individual minimum

[3] *Id.*, at 55362.

[4] *Id.*

capital requirement for a credit union that varies from any of the risk-based capital requirements that would otherwise apply under the Proposed Rule.

As noted in the Release, Section 1790d(b)(1)(A)(ii) of the Federal Credit Union Act requires comparability with the PCA requirements employed by the Other Agencies. The Release also states that NCUA's proposed PCA system "would replace the risk-based net worth method currently used by credit unions with a new risk-based capital ratio method that is more commonly applied to depository institutions worldwide and that the change in methodology would improve the comparison of assets and risk-adjusted capital levels across financial institutions." NCUA further states that, "[u]se of a consistent framework for assigning risk-weights would promote improved understanding between all types of federally insured financial institutions."[5]

Given that both the FDIC Interim Final Rule and Basel III's standard approach address only credit risk, by attempting to capture other risk exposures in its risk weightings, the Proposed Rule neither complies with the statutorily required comparability with the PCA requirements employed by the Other Agencies nor promotes improved understanding between all types of federally insured financial institutions. In addition, the Proposed Rule's approach is unnecessary inasmuch as the NCUA Rules include other regulatory measures and means to address risk exposures other than credit risk.

Considering the foregoing, we recommend that NCUA eliminate the portions of the Proposed Rule that apply higher risk weights to asset categories based on asset concentrations. Instead, NCUA should use individual minimum capital requirements or other supervisory assessments to require additional capital for credit unions with elevated risk exposures that result from ineffective policies, procedures, and practices with regard to their assets and operations.

We appreciate the opportunity to comment on the Proposed Rule and hope our comments are useful to NCUA.

Very truly yours,

Shutts & Bowen LLP

François G. Henriquez, II

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[5] 79 F.R. 11186.