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May 27, 2014

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

Via e-mail: regcomments@ncua.gov

RE: Comments on Proposed Rule: Prompt Corrective Action – Risk-Based Capital.

Dear Mr. Poliquin:

The MD I DC Credit Union Association, a trade association, representing the interests of over 150 credit unions across Maryland and District of Columbia with a combined membership of more than 2 million people living and working throughout the region. We appreciate the opportunity to submit comments on the National Credit Union Administration's (NCUA) proposed rule Prompt Corrective Action – Risk-Based Capital (RBC). We are committed to our members and the communities we serve through the strong leadership of the credit union movement in Maryland and DC by creating a collaborative environment that adds value through shared services, consumer awareness, and innovative market development.

The MD I DC Credit Union Association feels strongly we can all agree on the need for strong Risk-Based Capital requirements. However, given that credit unions managed to remain strong through the worst financial crisis in the past 80 years, this proposed rule as currently written is without merit. Furthermore, if the proposed rule is adopted as written, it will place an undue burden upon credit unions to comply. In fact, most affected credit unions would need to increase the amount of capital held in order to be well capitalized, and would likely face burdensome 'risk weightings' that would serve as a disincentive to continue or enter into member business and mortgage lending programs, and long-term investments, inevitably pushing members to credit unions' competitors.

We continue to review all aspects of the RBC proposal, its proposed effects on our member credit unions and our industry throughout Maryland and DC. We are also working with our trade association, the Credit Union National Association (CUNA) on their own analyses of the agency's proposed rule, its affects, and how it will affect our services and members.

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As you know, CUNA has estimated that if all affected credit unions acted to adjust their capital levels to maintain current margins above the "well capitalized" thresholds according to the RBC proposed rule requirements; credit unions would have to raise up to $7.3 billion in additional capital.

Proposed RBC effects on credit unions
NCUA estimates that over 90% of the credit unions with assets over $50 million, under the proposed rule applied today, would meet the minimum risk-based capital requirements. NCUA also estimates that only 200 credit unions would experience a decline in their PCA classification from well capitalized to adequately capitalized if the proposal were in effect now and 10 well capitalized credit unions would be downgraded to under-capitalized. However, CUNA estimates that a greater number of credit unions would fall from being comfortably well capitalized under the current system to being merely well capitalized under the proposed system. This is of great significance, as many credit unions may not be aware of the punitive nature of this rule when basing their analysis simply on the information provided by NCUA.

In Maryland, there are currently 44 federally-insured credit unions with assets over $40 million.* Of these credit unions:

- 2 would fall from well capitalized in the current system to adequately capitalized in the proposed system.
- 0 would fall from well capitalized in the current system to under-capitalized in the proposed system.
- Only 1 would enjoy a greater cushion above the well-capitalized threshold under the NCUA proposal.

The 44 federally-insured credit unions with assets over $40 million in Maryland would see their cushions over well capitalized shrink by a combined total of $0.1 billion if the proposal were in effect.

- These credit unions now have a cushion over well capitalized equal to 360 basis points on total assets.
- Under the proposal the cushion over well capitalized would decline to 313 basis points on total assets.
- This represents a -47 basis point change in the cushion over well capitalized.
- As a point of reference - these credit unions earned 56 basis points of ROA in 2013.

A total of 30 credit unions - 68% of the state's total - would see their cushions over well capitalized shrink if the proposal were in effect.

- The median increase in capital needed to maintain the current cushion above well capitalized is 73 basis points on assets for these credit.
- In all, 11 credit unions would experience a reduction in the cushion above well capitalized of at least 100 basis points on assets.

In District of Columbia, there are currently 20 federally-insured credit unions with assets over $40 million.* Of these credit unions:

- 1 would fall from well capitalized in the current system to adequately capitalized in the proposed system.
- 0 would fall from well capitalized in the current system to under-capitalized in the proposed system.
- Only 2 would enjoy a greater cushion above the well-capitalized threshold under the NCUA proposal.

The 20 federally-insured credit unions with assets over $40 million in District of Columbia would see their cushions over well capitalized shrink by a combined total of $0.01 billion if the proposal were in effect.

- These credit unions now have a cushion over well capitalized equal to 398 basis points on total assets.
- Under the proposal the cushion over well capitalized would decline to 389 basis points on total assets.
- This represents a -9 basis point change in the cushion over well capitalized.
- As a point of reference - these credit unions earned 27 basis points of ROA in 2013.

A total of 9 credit unions - 45% of the state's total - would see their cushions over well capitalized shrink if the proposal were in effect.

- The median increase in capital needed to maintain the current cushion above well capitalized is 93 basis points on assets for these credit.
- In all, 4 credit unions would experience a reduction in the cushion above well capitalized of at least 100 basis points on assets.

Proposed risk-weights

A number of the risk weights, especially for member business loan and mortgage concentrations as well as for CUSO investments, do not appear to be properly calibrated for credit unions. They are even higher than what is being imposed on banks by the BASEL III changes. Using higher risk weights on long-term assets to deal with interest-rate risk is misleading without considering liability maturities and other mitigating factors.

A number of the risk weights, especially for member business loan and mortgage concentrations as well as for CUSO investments, do not appear to be properly calibrated for credit unions. With respect to member business loans, not all business loans are considered equal. Some MBL’s are considered very low risk, therefore we should get credit for them. They are even higher than what is being imposed on banks by the BASEL III changes. Using higher risk weights on long-term assets to deal with interest-rate risk is misleading without considering liability maturities and other mitigating factors.

* While the NCUA risk-based capital proposal focuses on credit unions with $50 million or more in assets our analysis includes credit unions greater than $40 million because we assume that those between $40 and $50 million are likely to grow above the $50 million mark in the near future.

At the very least, risk weightings on MBL and investments should be reduced so as to be comparable to what is imposed on community banks under BASEL III. The fact is that credit union delinquency and losses on these loans are demonstrably lower than community banks.

Investments

Under the proposed rule, investment risk weightings for credit unions are significantly higher than that of banks. The NCUA risk weights appear to be punitive and somewhat inconsistent when compared to banks thus putting credit unions at a disadvantage. All Treasury securities and those securities guaranteed by the NCUA or FDIC carry a 0% risk weight, no matter what the maturity. Other Agency backed securities with no credit risk, such as FMNA and Freddie Mac, are risk weighted based on weighted average life time buckets. Investments with weighted average lives greater than 5 years are given punitive risk weights of 150% for 5 to 10 year average lives and 200% for average lives greater than 10 years. This compares to 20% risk weightings for similar securities in the banking model.

Real Estate Loans

Under the proposed rule, no distinction is made on the risk weightings assigned to mortgage loans of various maturity and repricing terms. A 30 year fixed rate mortgage gets the same risk weight as a 1 year adjustable rate mortgage and a 30 year fixed rate home equity loan gets the same risk weight as a variable rate home equity line of credit. As opposed to implementing risk-based capital standards that unfairly lump all mortgage loans together there should there be more diversity in the risk weighting. We believe that the capital requirement for adjustable rate mortgages and shorter maturity fixed rate mortgage loans should be lowered in the final version of the Rule to fairly take into consideration the reduced risk associated with these adjustable and shorter term mortgage loan products.

Member Business Loans

The proposed rule creates a bias in favor of consumer loans as opposed to other assets such as member business loans. Consumer loans are assigned a 75% risk weighting while member business loans are subject to concentration-based tiered risk weights.

If the rule was to become final, some member credit unions may opt to increase production in lesser quality indirect and unsecured consumer loans rather than higher quality, more secure member business loans in an effort to preserve capital. NCUA should reconsider and remove portions of the proposed rule that apply higher risk weights to member business loans based on a percentage of the credit union's assets in that category.

CUSO Investments

As with the investments listed above, not all CUSO's are created equal. We encourage NCUA to implement regulations that encourage the use of CUSOs to generate net income and remove all regulatory impediments to CUSOs and collaboration. We recommend the removal or at least lowering of risk ratings for CUSO investments and loans as immaterial, inapplicable to CUSO investments and to encourage CUSO investment for policy reasons. Simply put, if a CUSO has paid for itself it should not be counted as a risk asset.

NCUSIF 1% Deposit to be ignored

NCUA’s requirement that the National Credit Union Share Insurance Fund 1% deposit be ignored in the risk-based capital calculation should be reconsidered. The justification for removing the deposit is unclear, yet quite significant. Indeed, the NCUSIF deposit is a valid asset that can be refunded for various reasons including conversion to a bank or savings institution charter, a credit union electing private insurance instead of NUCA or voluntary liquidation. In addition, the deposit can specifically be attributable to a failed credit union providing an additional buffer against NCUSIF losses in addition to the failed credit union's capital. If a credit union did convert to a bank charter the NCUSIF deposit would immediately be included in the risk based capital numerator. We recommend not deducting the NCUSIF deposit from the risk-based capital numerator.

Examiner discretion to change risk ratings

Proposed section 702.105(c) as currently worded is troubling and unclear in that NCUA would assume additional authority to impose higher capital requirements on individual credit unions that could exceed even well capitalized level requirements. Unlike under the existing statutory net worth rules known as Prompt Corrective Action (PCA) regulations, credit unions would no longer have clear rules to avoid prompt corrective action imposed by NCUA if the agency can establish its authority to use “judgment” on a credit union-by-credit union basis to make changes to risk ratings. This section of the proposed rule if left unclarified, could open the door to inconsistent and potentially arbitrary application of the intended rules. In addition, would significantly diminish the responsibility of boards and management to make critical financial judgments, determine the strategic direction of the credit union, and oversee policy. Our recommendation is to remove section 702.105(c) from the proposed rule entirely. However, at the very least amend the language to make clear the intent with respect to the examiner’s authority to use “judgment.”

Mortgage Loan Servicing Risk Rating

In our opinion, the mortgage servicing risk rating of 250% appears out of sync. What is the rationale for such a relatively high weight, which mirrors FDIC’s weighting. The high-risk rating will likely discourage many credit unions from loan participations. Indeed, in light of a recovering, currently active mortgage market, we recommend that the agency consider significantly reducing if not eliminating mortgage servicing rights completely as a risk asset. Without loan participations, many credit unions may not have sufficient interest income to survive. The fact is it is a good hedge against interest rate and the change in value should be recognized on a monthly basis.

Implementation Date

We are also recommending that the proposed implementation date of eighteen months after the regulations becoming final be extended. This proposed time-frame does not give credit unions sufficient lead time to plan for the new risk based capital ratio requirements and other proposed changes to part 702 and implement them properly. This is particularly important as many credit unions may wish to alter their balance sheet composition in response to the rule. We are urging the agency to provide a much longer implementation period, particularly in light of the multi-year development and implementation of Basel III for banks which initially allowed for a three year period but has since been extended.

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Conclusion
The MD I DC Credit Union Association appreciates the value of a financial institution's capital as a durable source of funding that can be readily deployed to shore up a balance sheet under duress and the need for regulatory oversight. In that spirit, we are asking NCUA to carefully weigh the comments received and consider withdrawing this flawed proposal in favor of opening a new productive dialogue with the credit union community regarding warranted and balanced risk-based capital reform. Short of that, at the very least, we urge NCUA to pursue the appropriate amendments to this rule that will ensure a viable, well-balanced risk-based capital system is implemented.

Thank you for the opportunity to comment on the proposed rule Prompt Corrective Action – Risk-Based Capital. Additionally, should NCUA amend the proposed regulations as many industry stakeholders and Members of Congress are now urging, we ask for an additional public comment period in order for all interested parties to evaluate and fully understand the changes.

Should you have any questions, please contact me at jbratsakis@mddccua.org or 443-325-0774.

Sincerely,

John Bratsakis
President & CEO

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