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

Via email to: regcomments@ncua.gov

Re: UNFCU - Comments on Proposed Rule: PCA - Risk-Based Capital

Dear Mr. Poliquin:

On behalf of the United Nations Federal Credit Union (UNFCU), we are writing in response to the National Credit Union Administration (NCUA) Board's invitation for comments on the above referenced proposed rule for risk-based capital. UNFCU appreciates the opportunity to comment on the new proposal regarding risk-based capital and to make suggestions to improve the final rule.

The Risk-Based Capital Rule was proposed as a way to improve the measurement of the credit union industry's capital risks and to also further strengthen the industry overall. As such, UNFCU initially supported NCUA's efforts in introducing risk-based capital metrics and appreciates the Board's acknowledgement of the industry's comments and concerns. Certainly, the second proposal has alleviated a significant amount of concern, however, this new version still weakens the industry by continuing to propose onerous risk weights in certain instances while requiring an increase in operating costs on an already overly burdened industry. Furthermore, the Rule will likely only provide the benefit of the identification of a small number of outliers as having capital deficiencies, yet those credit unions that have consistently been considered well capitalized and prudently managed, will nonetheless still be exposed to such additional costs.

The Risk-Based Capital rule, as promulgated, is unduly burdensome and unnecessary, whereas the established leverage ratio has already proven adequate in protecting the insurance fund. Currently, the leverage ratio for credit unions to be adequately capitalized is 6%, which is sufficient to cover the capital risks that affect the vast majority of the credit union industry. Additionally, the NCUA's leverage ratio is already 50% higher than the FDIC requirement of 4% and credit unions lack the ability to raise supplemental capital. As the current leverage ratio has been a successful measure for the industry as a whole, we suggest the NCUA reconsider issuing a final rule on risk-based capital.

Ultimately, if a Risk-Based Capital rule is inevitable, UNFCU would like to acknowledge that the second proposal greatly improves upon the first version by removing most interest rate risk considerations from risk weights and deferring the time allowed for implementation amongst

other positive changes. While the current proposal is more in line with the FDIC standards, there are still areas where the rule can be detrimental to the sustainability and growth of the credit union industry. The current applications of loan risk weights are inconsistent and will still negatively affect the business decisions of credit unions in how they diversify their asset classes. In some cases, the asset risk weights do not accurately reflect the underlying risks associated with the asset. The proposed risk-based capital rule may also discourage credit unions from engaging in businesses that are stable and benefit members including CUSOs. Lastly, the rule does not introduce supplemental capital as a means for credit unions to raise capital. The NCUA should support supplemental capital authority as this would be in line with the goals of risk-based capital to strengthen the credit union industry.

Loan Risk Weights

While the NCUA has made significant progress with the latest risk-based capital proposal regarding the appropriate risk weights to be assigned to various assets, the rule continues to use a tiered approach to the risk weights for mortgage loans. If all loans are underwritten in essentially the same manner, there is no need to require additional capital for Current First Lien Residential Real Estate Loans (CFLRREL) in the portfolio greater than 35% of assets. These loans are usually conservatively underwritten and are secured by real property. Originated loans also typically have loan-to-value ratios of less than 80% and the vast majority of loans are significantly lower. It is strongly requested that the NCUA reconsider this flawed approach. Under the current proposal CFLRREL that amount to more than 35% of assets would receive a risk weighting of 75%. Given the characteristics of these loans described above it would be appropriate to eliminate the tiered approach and to risk weight these loans at 50%. This would also be in line with how the FDIC risk weights these loans. To keep this tiered approach may also result in credit unions curtailing loan production as they approach the next tier because of the higher capital levels. These tiers will then affect the member's ability to receive the best services from their credit union. It is in the best interest of members and credit unions alike to keep the risk weights consistent without tiers.

We also recommend dropping the tiered approach on commercial and consumer loans while adopting a more consistent risk weighting regardless of the portfolio to total assets ratio.

CUSO

CUSOs are an important part of how credit unions serve the needs of their members and investments in CUSOs further that goal. The revised proposed risk weighting for CUSOs of 150% is a vast improvement over the 250% that was originally proposed in 2014, but is still too high. To impose a risk weighting of 150% appears excessive in light of the actual risks presented by CUSOs. A risk weighting of no more than 100% would better align with the actual risks of investing in a CUSO.

If CUSO investments are risk weighted too heavily this will prevent credit unions from continuing to invest in CUSOs and thus members will not receive the critical services that CUSOs offer. Thus, it is important that the investment risk weights from the rule align with the actual risks that are posed by the CUSO to incentivize credit unions to invest in CUSOs and continue to offer members the best and most competitive services.

Supplemental Capital

Currently, the only source of capital for credit unions is their retained earnings. While this has served the credit union industry well it limits the ability of healthy, well managed credit unions to grow. UNFCU supports the introduction of supplemental capital and it should be coordinated with the implementation of risk-based capital.

Interest Rate Risk

With the removal of interest rate risk from the risk-based capital proposal the NCUA has requested that credit unions comment on alternative approaches to managing and supervising interest rate risk. The current practice of reviewing a credit union's interest rate risk as part of the annual examination process would provide sufficient oversight to control interest rate risk at individual credit unions. We see no pressing need to change this at this time. Unfortunately, one approach to interest rate risk that has been suggested is additional rulemaking. As there are already a number of industry accepted methods to measure a credit union's interest rate risk, additional rulemaking is unnecessary and would add to an already overburdened industry.

Investments

Overall, the risk weights placed on a credit union's investment securities are much improved in the most recent proposal when compared to the original. Most importantly, it was a relief to see the removal of unfair high risk weights applied to certain longer weighted average life securities and their replacement with lower weights based on a security's credit risk exposure. This approach also appears to be in parity with the FDIC capital regulations. However, there are still some suggestions that can be made to improve the investment security risk weights as they are currently proposed:

1) We recognized that the general obligation and revenue bond proposed risk weights are on par with the current FDIC measures, however, it is important to remind the Board that this does not necessarily imply that revenue bonds are broadly exposed to more credit risk that that of general obligations. In fact, some revenue backed municipal securities (e.g. state or city financing authorities) are secured by certain taxes that are also available to the same municipal sponsor. However, in those cases of revenue secured bonds, such pledges are often less leveraged, with higher debt service coverage ratios, and sometimes with even higher credit ratings than "ad valorem" municipal pledges. Also, revenue authorities that are business enterprises of municipalities (e.g. power and water-sewer authorities) often do not have the exorbitant pension liability overhang that have been severely detrimental to certain general obligations issuers (e.g. City of Detroit, State of Illinois, State of New Jersey and the City of Chicago). Lastly, there are taxable revenue bond issuers available for credit union investment portfolios that may have 10-20 times net debt service coverage ratios (as measured by net operating income divided by principal and interest service obligations in the most recent year).
2) As currently structured in the most recent proposal, it is unclear precisely where non-agency commercial mortgage-back securities (referred to as commercial mortgage-related securities in part 703) would fall in the updated list of risk weights.
3) Finally, although the Board mentions its intention of removing interest rate risk considerations from the revised risk weights, there does appear to be a subtle reference to such risks in one particular investment class. More specifically, the

Board is proposing a higher risk weight of 100% for agency backed interest and principal only securities, a much higher level than other agency mortgage securities. Such types of securities are structured to either reduce or increase interest rate risk, yet still have the same credit exposure as more standard mortgage pass-through pools. We recognize that such securities are more complicated to model and to trade than standard pools, however, is the Board penalizing credit unions for holding these positions by means of higher risk weights due to their complexity or is the penalty indeed addressing interest rate risk?

Conclusion

While UNFCU recognizes the NCUA's introduction of risk-based capital standards are likely forthcoming, the rule in its current form will result in costly and unnecessary burdens on credit unions unless more changes are made to the proposed rule. Accordingly, UNFCU respectfully requests that the risk weight ratio applicable to loans and investments become more consistent with their underlying risk as well as more aligned with what the FDIC adopted. The final rule should also have lower risk weight ratios for CUSO investments. Lastly, supplemental capital should be authorized as it is an important tool to assist credit unions in complying with the impending risk-based capital standards.

Thank you again for allowing additional comments on the proposed rule and for your consideration of UNFCU's position.

Very truly yours,

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cc: William Predmore, President/CEO, UNFCU