Redwood
Credit Union

April 14, 2015

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

Re: Comments on Proposed Rule: Risk-Based Capital

Dear Mr. Poliquin:

Redwood Credit Union (RCU) appreciates the opportunity to comment on NCUA's latest revised Risk-Based Capital proposal (RBC2). RCU is a federally insured California-chartered credit union with $2.5 billion in assets and 240,000 members. Our Net Worth and Risk-Based Capital (proposed) ratios are 11.4% and 20.8%, respectively, as of December 31, 2014.

We recognize that RBC2 reflects substantial changes from the previous proposal issued in early 2014, and we commend the NCUA Board for taking to heart the unprecedented feedback received from throughout the credit union industry, as well as the U.S. Congress.

RCU supports the concept of risk-based capital and believes credit unions should maintain levels of capital that are commensurate with their level of risk. That said, we are concerned that RBC2 does not advance the cause of simultaneously improving the safety and soundness of the credit union industry while ensuring credit unions maintain strong business models based on providing relevant products and services to their members. Given the hardy resilience of natural person credit unions, especially compared to banks, during the Great Recession, we question whether it is warranted at all. **Accordingly, we strongly encourage the NCUA Board to reconsider the need for any risk-based capital regulation.**

To the extent that RBC2 moves toward implementation, there are number of areas within RBC2 that warrant change. These areas include risk weightings for CUSO investments and mortgage servicing assets, and the treatment of goodwill. We are also concerned about the uncertainty of pushing interest rate risk into a yet-to-be-created new regulation.

CUSO Investments

CUSO (non wholly-owned) investments with a risk weighting of 150% is out of proportion with the risk. We are not aware of any CUSO losses that have had a material impact on any credit union or the National Credit Union Share Insurance Fund. Accordingly, we believe the risk weighting should not exceed 100%. If there are in fact CUSO types that have a track record of losses, we encourage you to differentiate the risk weightings for higher-risk CUSO types.

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A bigger problem with the 150% risk weighting is the unintended consequence of discouraging shared resource CUSOs. These are CUSOs that are formed for the purpose of providing a shared resource (e.g., IT, compliance, mortgage processing) for multiple credit unions. The goal of a shared resource CUSO is not to generate dividend income so much as to promote operational efficiencies and specialized expertise. We believe strongly the credit union system is better served by having more, not fewer, shared resource CUSOs, and that NCUA should be encouraging, and not discouraging, their formation.

Mortgage Servicing Rights

Mortgage servicing assets (MSAs) with a risk weight of 250% is out of proportion with the risk. The risk comes from declining MSA values during a period of falling interest rates. However, generally accepted accounting principles (GAAP) require credit unions to record MSAs at fair value. Thus, the risk of over-valued MSAs doesn't exist for credit unions that follow GAAP. Further, we are not aware of any credit union that has suffered a material impact to its capital as a result of declining MSR values. Finally, the high risk weight may have the unintended consequence of discouraging some credit unions from selling their fixed rate mortgage output, thereby taking on more interest rate risk by holding more fixed rate real estate loans. The risk weighting for MSRs should not exceed 100%.

Goodwill

RBC2 proposes to handle Goodwill a haphazard manner. Goodwill resulting from a "supervisory merger" would be allowed to be counted as capital until 2025, after which it would have to be deducted from capital. While we appreciate that supervisory merger is broadly defined to include any regulatory-assisted merger regardless of whether financial assistance is provided, the 2025 sunset date is nevertheless arbitrary. RBC2 requires the opposite treatment for Goodwill arising from a merger not deemed "supervisory," whereby it would be deducted from capital from day one.

The different treatments and the arbitrary sunset data for Goodwill arising from a supervisory merger are problematic. One problem is that GAAP requires companies to subject their Goodwill to rigorous testing for impairment on an annual basis. Accordingly, the proposed regulation's treatment of Goodwill effectively contradicts GAAP. The second problem is the likely chilling effect on mergers, despite the differentiation for Goodwill arising from supervisory mergers. Viable credit unions will be discouraged from taking on less viable credit unions, regardless of whether it's a supervisory merger. It is not hard to fathom that this will also raise the cost of resolving troubled credit unions which will negatively impact the whole credit union system. We encourage you to allow all Goodwill, regardless of whether it results from a supervisory merger or not, to be counted as capital and to eliminate the 2025 sunset date.

Interest Rate Risk

We commend the NCUA Board for excluding interest rate risk weights from RBC2. This removes a big source of the arbitrariness of the risk weightings contained in the first proposal. However, we are concerned that NCUA feels compelled to issue a new proposal on interest rate risk. This would be in addition to the Interest Rate Risk Policy and Program adopted in 2012. We believe that existing interest rate regulatory, supervision, and examination process is appropriately commensurate with the real world risk, whereby no credit union failure has yet to be attributed to interest rate risk. Our concern is that a new interest rate risk regulation will be prescriptive and unnecessarily restrain credit union risk management. We strongly oppose any new interest rate risk rules at this time.

We are submitting our comments with the expectation that it is in the common interest of all parties – credit unions, credit union members, NCUA, and NCUSIF – to have a rational risk-based capital approach that is consistent with and encourages sound risk management practices and aligns well with business strategies for maintaining or increasing relevance to our members and communities.

Sincerely,

Wade Painter, EVP / Chief Financial & Risk Officer
Redwood Credit Union
Santa Rosa, CA

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