CUNA
Credit Union National Association

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

Re: NCUA's Risk Based Capital Proposal, RIN 3133-AD77

Dear Mr. Poliquin:

The Credit Union National Association (CUNA) appreciates the opportunity to submit comments to the National Credit Union Administration (NCUA) Board's request for comments on the NCUA's second proposed-risk based capital rule (RBC2). By way of background, CUNA is the national trade association for America's state and federally chartered credit unions. CUNA represents approximately 90% of America's 6,500 credit unions and their 102 million memberships.

RBC2 represents an improvement over the original proposal NCUA issued last year, but it remains fundamentally flawed. It is a solution that will not work to a problem that does not exist. As we discuss below, NCUA has ignored its obligation to consider the cooperative nature of credit unions when creating a risk-based capital regime comparable to FDIC; CUNA continues to question NCUA's authority to establish a risk-based capital standard for the purposes of determining whether a credit union is well-capitalized; we feel NCUA has failed to satisfactorily demonstrate a compelling need for the proposal; we have serious concerns regarding the proposal's capital adequacy plans, risk-weights, and treatment of goodwill; we believe the proposed definition of complex credit union does not adequately reflect credit union complexity; we encourage NCUA to provide credit unions greater flexibility than what is proposed with respect to providing data on the Call Report; and we encourage NCUA to delay the implementation date until 2021. In addition, we have provided comments, as requested, on the need for additional interest rate risk (IRR) regulation and the use of supplemental capital for the purposes of this proposed rule.

I. NCUA Has Ignored its Obligation to Consider the Cooperative Nature of Credit Unions When Creating a Risk-Based Capital Regime Comparable to FDIC

One of the most troubling elements of the RBC2 proposal is the pervasive implication that credit union capital requirements, and also regulation and supervision, should be modified to be more like those applied to Federal Deposit Insurance Corporation (FDIC) insured institutions. The Federal Credit Union (FCU) Act does indeed require NCUA to establish a risk-based capital system that is comparable to that in place for FDIC insured banks; however, the Act also instructs NCUA to take into account the cooperative character of credit unions.[1] In drafting the proposal, the agency appears to have devoted itself to the comparability requirement, while ignoring the cooperative nature of credit unions.

This issue goes beyond the RBC2 proposal. A number of NCUA initiatives since the financial crisis appear driven by the view that NCUA's regulation and supervision of credit unions should mimic the practices and policies of the federal banking regulatory authorities.

But credit unions are not banks. Because of their unique cooperative structure, strong member focus, and the absence of stock options for executives or pressure from stockholders, these not-for-profit institutions with democratic governance eschew excessive risk taking.[2] Because credit unions take on less risk, they tend to be less affected by the business cycle, and therefore can serve as an important counter cyclical economic force in local markets, softening the blow of economic downturns in local economies. Indeed, in the face of the recent financial crisis credit unions – unlike their counterparts in the for-profit banking sector – served as *both* a counter-cyclical force *and* a safe haven, with much stronger loan and deposit growth than banking institutions.

If credit unions are regulated and supervised more and more like banks, they will act more and more like banks. That would be a tragic loss for the consumers of financial services in America's working and middle class.

II. NCUA Does Not Have the Statutory Authority to Establish a Risk-Based Capital Standard for the Purposes of Determining Whether a Credit Union Is Well-Capitalized

NCUA has proposed a risk-based capital regime that includes a higher risk-based capital requirement for a credit union to be well-capitalized than to the risk-based capital requirement for an adequately capitalized credit union, despite the fact that the FCU Act directs NCUA to connect risk-based requirements to the sufficiency of a credit union's net worth for the **adequately-capitalized classification only.[3]**

We have previously outlined our view that NCUA lacks the legal authority to implement a risk-based capital requirement for a credit union to be well-capitalized in our comment letter on the previous proposal (RBC1) and legal opinion provided to NCUA staff. This position is supported by several Members of Congress who were directly responsible for the development of this provision of the FCU Act and who commented on the previous proposal, including the former chairman of the Senate Banking Committee, who said:

[1] 12 U.S.C. § 1790d(b)(1)(B).
[2] Edward J. Kane and Robert J. Hendershott, *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers*, Journal of Banking and Finance, 20 (September, 1996), pp. 1305-1327. Kane and Hendershott describe how the cooperative structure of credit unions presents credit union decision makers with incentives that are strikingly different from those faced by a for-profit financial institution, making it less feasible for credit union managers to benefit from high-risk strategies.
[3] 12 U.S.C. § 1790d(d)(2).

> "[W]hen we included in the law the language: 'The Board shall design the risk-based net worth requirement to take account for any material risk against [which] the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection,' we meant just that, adequately capitalized. If we had intended there should also be a separate risk-based requirement to be well capitalized (in addition to the 7% net worth ratio), we would have said so."[4]

Given the preponderance of evidence which suggests that NCUA does not have the authority to establish a risk-based capital requirement for the purposes of determining whether a credit union is well-capitalized, we urge NCUA in the strongest terms possible to revise the proposal consistent with current law. If NCUA feels it needs the authority to establish a requirement for well-capitalized credit unions, it must go back to Congress and ask for the authority.

Even though CUNA continues to disagree that NCUA has legal authority to implement a two-tiered approach in RBC2, NCUA made improvements by lowering the threshold for a well-capitalized complex credit union from RBC1's proposed 10.5% to 10%. This remains well above the proposed 8% requirement for an adequately capitalized credit union. While this treatment is preferable to RBC1, we still have concerns that the new approach is inconsistent with the FCU Act for the same reasons stated in our RBC1 comment letter.

III. NCUA Has Failed to Demonstrate a Compelling Need for the Rule

In addition to the lack of a statutory footing for the proposal, there is virtually no evidence of the need for a revision of credit union capital standards, particularly one modeled on commercial bank Basel-style risk-based capital requirements. As Chairman Matz noted in her December 2011 letter to the Governmental Accountability Office, "consumer credit unions performed very well during the worst financial crisis since the Great Depression and NCUA was highly successful overall in mitigating failures and losses for consumer credit unions."[5]

The financial crisis that began in 2007 exposed the U.S. financial system to a perfect laboratory test of the adequacy of capital requirements and prudential regulation. A comparison of the performance of the two deposit insurance systems in the U.S., the National Credit Union Share Insurance Fund (NCUSIF) and FDIC during and after the financial crisis demonstrates that the credit union capital regime, as currently structured, is remarkably robust. The same is not true of the bank system, and that fact has led to substantial changes to the FDIC's funding and bank capital requirements. Those changes are entirely appropriate given the shortcomings exposed by the financial crisis. But similar shortcomings were not revealed for the credit union system, and there is therefore no case for NCUA to adopt any of the recent initiatives launched by the FDIC.

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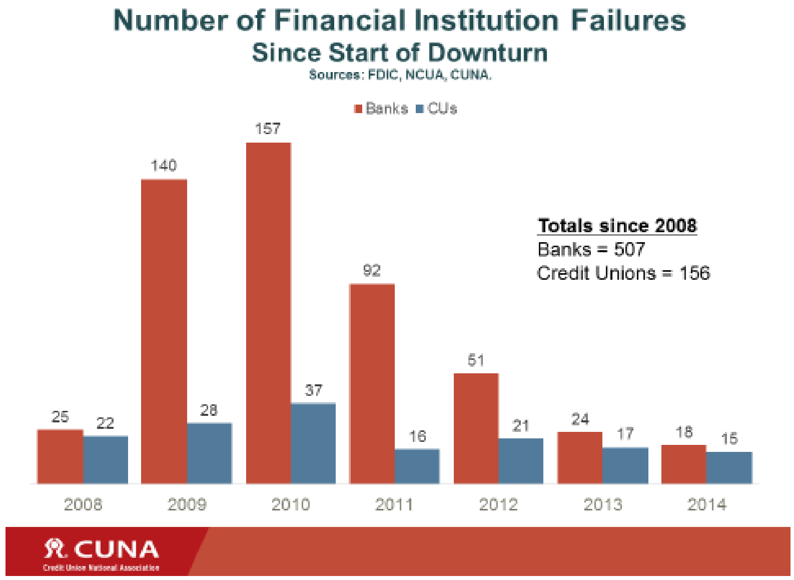
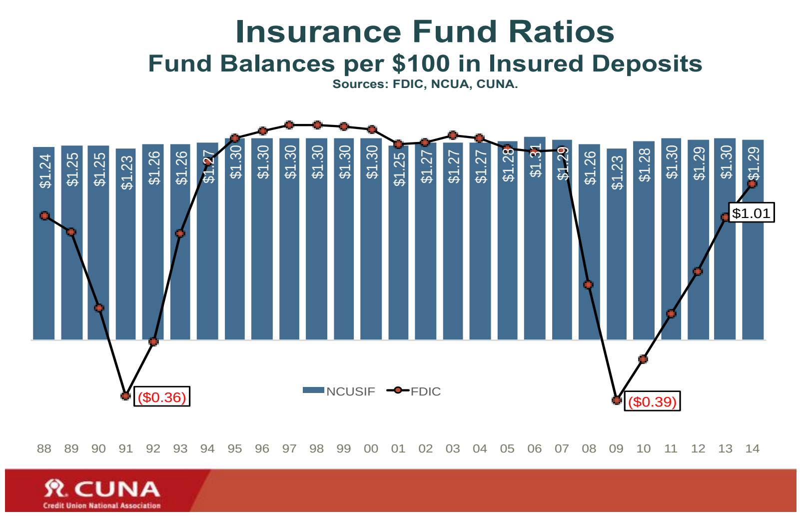
[4] Letter from Senator Alfonse M. D'Amato to Mr. Gerard Poliquin, Secretary of the Board, National Credit Union Administration. May 7, 2014.

[5] Letter from NCUA Board Chairman Debbie Matz to Ms. A. Nicole Clowers, Director Financial Markets and Community Investment, United States Governmental Accountability Office. December 19, 2011.



From 2007 to 2012, 465 commercial banks failed, and the FDIC's Deposit Insurance Fund (DIF), battered by insurance losses, fell into negative territory at -0.39% of insured deposits in 2009, despite combined premium assessments in 2008 and 2009 of 27 basis points[6]. Since then, with the help of additional assessments totaling 46 basis points, and reversals of previous insurance loss estimates, the DIF has recovered to 1.01% of insured deposits. Because of the stresses this episode placed on the DIF, Congress passed a number of FDIC reforms in the Dodd-Frank Act, and the FDIC board has adopted a policy of increasing the size of the DIF far beyond its previous level, which typically fluctuated in the range of 1.2% to 1.4% of insured deposits.



[6] Until the first quarter of 2011, FDIC levied premiums on "assessable deposits". Since then premiums have been based on "assets less tangible equity", roughly total deposits plus liabilities. Both of these assessment bases are larger than insured deposits.

The experience of the credit union system and its deposit insurance fund could not have been more different. Credit unions lived through the same severe financial crisis, but with strikingly different results. From 2008 to 2012 the NCUSIF fund balance never fell below its historical range of 1.2% to 1.3% of insured deposits, despite the failures of 124 credit unions. This stability in the fund ratio was accomplished with just two share insurance premiums, in 2009 and 2010, totaling 24 basis points of insured shares.

In other words, credit unions successfully navigated through the most severe economic catastrophe in modern economic times – and without the benefit of the proposed RBC regulations. During this episode, banks faired much worse operating under a Basel-style capital requirement system similar to the one being proposed for credit unions in the RBC2 proposal.

FDIC vs NCUSIF Performance
(2008 – 2012)

	NCUA	FDIC
Deposit Insurance Fund Balance		
% of Insured Deposits		
Initial (2007)	1.29%	1.22%
Lowest (2009)	1.23%	-0.39%
Ending (2012)	1.29%	0.44%
Number of Failed Institutions	124	465
% of failures with > $100 million in assets	21%	79%
% of failures with > $50 million in assets	24%	92%
Total Insurance Premiums (bp)	24	73

Not only has the agency failed to demonstrate the need for the proposal, the risk-based structure it has proposed would do very little to reduce future insurance fund losses. This is because, by our analysis, it would not have noticeably reduced insurance losses during the recent crisis had it been in effect. The proposal states that 27 credit unions with assets greater than $50 million failed between 2008 and 2012 – costing the insurance fund $728 million.

Our analysis of the 26 credit unions with more than $80 million in assets just before the crisis (as of December 2007) that subsequently failed reveals that only seven would have had a lower capital classification under RBC2 than they in fact had under current rules. Six of the 21 well-capitalized credit unions under current rules would have been downgraded, four to being adequately-capitalized, and two to undercapitalized. One adequately-capitalized under current rules would have been classified as undercapitalized under RBC2. In other words, of the 26 failures, a total of just three would have been demoted to being undercapitalized by RBC2, and therefore subject to net worth restoration plans. And the amount of capital they would have been required to obtain to become adequately-capitalized is only $7 million, as compared to the insurance loss of over $700 million. Further, the amount of capital that would have been necessary for all seven downgraded credit unions to regain their previous capital classifications (six to well-capitalized, one to adequately-capitalized) would have totaled a mere $43 million.

Capital Classifications as of December 2007
of 26 Credit Unions that Subsequently Failed

	Current PCA System	RBC2	Change from Current to RBC2
Well Capitalized	21	15	Down by 6: 4 to adequate, 2 to under
Adequately Capitalized	2	5	Up by 3: 4 from well, 1 to under
Undercapitalized	2	5	Up by 3: 2 from well, 1 from adequate
Critically Undercap'd	1	1	No change
Total	26	26	19 no change, 7 to lower classifications

If a goal of a Prompt Corrective Action scheme is for covered institutions to hold sufficient capital to withstand a severe financial crisis without imperiling the deposit insurance fund, the results of the lab test that was the recent financial crisis are compelling evidence that a major overhaul of credit union capital requirements toward a Basel-style system is simply not required.

IV. The Proposed Capital Adequacy Plan Imposes Systemically Significant Financial Institution Stress Testing Requirements on Well-Capitalized and Significantly Smaller Credit Unions

Credit unions are understandably very concerned about NCUA's proposed additional provisions regarding capital adequacy. Potentially, these provisions could be among the most problematic for credit unions in RBC2 because they would grant examiners considerable latitude to determine whether a credit union needs more capital even if it is well-capitalized according to standard net worth and risk-based capital ratio requirements.

Under RBC2, complex credit unions would be required to develop a capital adequacy plan to assess the sufficiency of their capital on an ongoing basis, and set aside capital that is over and above the 7% net worth and 10% RBC requirements. The credit union's plan, assessment, and amount of additional capital set aside would all be subject to examiner review.

These requirements are not necessary for the vast majority of complex credit unions based on their management, risk profiles, and current levels of capital. If NCUA examiners have concerns regarding the credit unions they supervise, those situations should be addressed on an individual basis and not through rulemaking that would apply universal requirements to all complex credit unions, regardless of how well managed they may be. As we show elsewhere in this letter, credit unions and the NCUSIF have functioned well without these provisions and NCUA has not provided sufficient justification to support their imposition now.

In recognition of the unique characteristics of credit unions and their lower risk profile, Congress did not intend for credit unions generally to be subject to higher capital requirements than what the FCU Act directs. We reject the notion that the thresholds for a credit union to be well-capitalized as established by Congress are in any sense "minimum" capital requirements. If Congress had intended that to be the case, it would have described the classification as minimally capitalized. Well-capitalized means well-capitalized, plainly and simply. If a credit union meets the net worth and risk-based capital requirements to be well-capitalized, the sufficiency of its capital should not be an issue in terms of any rule that could require it to hold additional capital to be considered well-capitalized.

Even if NCUA had sufficient authority to establish higher capital requirements beyond thresholds that Congress authorized it to implement by regulation, a requirement for even more capital beyond what RBC2 anticipates would be overkill.

In light of these concerns, CUNA strongly opposes the capital adequacy plan requirements in RBC2. Strategic capital planning is very important for credit unions, and each credit union's long-term desired capital ratio will depend on the credit union's own assessment of the risks it faces, and its tolerance for risk. Such a plan, which for many credit unions includes a buffer of additional capital to stay above regulatory requirements, should not be the subject of examination and supervision, and the goals a credit union establishes for its own capital sufficiency should not become targets or standards for review in an examination.

CUNA urges NCUA to delete the capital adequacy provisions from the RBC2 proposal.

V. The Definition of Complex Should Be More Complex Than An Asset Threshold Which is Much too Low

Like its predecessor, RBC2 would use asset size as a proxy for complexity, leaving us with the same concerns about the definition of "complex" as we detailed in our RBC1 comment letter. Size should not be the only determinant for whether RBC requirements apply. Raising the asset size from $50 million to $100 million does, however, improve a flawed definition simply by impacting fewer credit unions. While we agree that the $50 million level was far too low for the rule's threshold, $100 million is not the appropriate cut-off for application of the rule either.

As we stated in our comment letter last year, the FCU Act says NCUA should define "complex" based on the "portfolios of assets and liabilities of credit unions." It is unclear why NCUA is not following this direct instruction from Congress and is concentrating only on the size of a potentially complex credit union. If Congress had wanted the application of the PCA rules to be based on asset size, it simply would have required that NCUA use asset size to determine which credit unions fall under the requirements.

To be more consistent with the FCU Act, we recommend that NCUA increase the proposed $100 million threshold to $500 million and that the threshold be used in combination with actual operational complexity as measured by the agency's Complexity Index. Thus, we propose that all federally insured credit unions with assets of $500 million or under be excluded from the definition of "complex" and that only those credit unions with assets above $500 million and that have an NCUA Complexity Index (discussed in the Supplementary Information to RBC1) value of 17 or higher be required to meet risk-based capital provisions.

There is little danger to the credit union system with "complex" being defined as credit unions with $500 million or more in assets because two-thirds of NCUSIF insured shares are in these credit unions. NCUA would still have the authority to adjust the definition to include more credit unions in the future if the determination is made through the annual one-third regulation review that an insufficient amount of credit union assets are covered by RBC2. A measured approach would ensure that the proper number of assets eventually fall under RBC requirements. The burden will be lower using a $500 million threshold because fewer credit unions would initially be subject to RBC requirements. Subsequently expanding the threshold, if necessary, is less costly and burdensome than starting off applying the requirements to such a high number of credit unions.

As with any requirement based on a number that increases with inflation and the general growth of any industry, whatever number that NCUA chooses to define "complex" should be indexed. In addition, consistent with the current practice, any credit union that is identified as "complex" by NCUA should be able to present evidence to the agency as to why it is not complex and thus, should not be subject to risk-based capital requirements. The process for contesting an agency designation of "complex" should also be detailed in the final rule.

NCUA should provide a better tailored definition of "complex" to ensure that the only credit unions covered are those with activities that pose extraordinary risk, beyond routine loans and investments, for which their adequately-capitalized-level net worth does not provide adequate protection. This approach is consistent with the FCU Act and will result in a more reasonable application of risk-based capital requirements than relying on asset size alone to determine whether the definition of 'complex" has been met.

VI. NCUA Should Better Calibrate RBC2's Risk Weights

RBC2 makes a number of positive changes to RBC1's proposed risk weightings. Improvements include the removal of weighted average life components from risk weights for investments and changes to risk-weight escalation for higher concentrations of real estate and member business loans. Other examples of improved treatment under RBC2 include the designation of 1-4 family non-owner occupied mortgage loans as residential loans, subject to lower risk weightings than if NCUA had categorized the loans as member business loans. Unfortunately, RBC2's risk weights remain too high in key areas, given credit unions' level of risk, and they should be lower than what the federal bank regulators require for assets such as mortgage loans, member business loans, servicing and certain investments. Lower risk weightings for credit unions are appropriate given their different incentives to manage risk as compared to banks, and lower loss history as detailed in our comment letter on RBC1.

Specifically, current first lien residential mortgage loans over 35% of assets would have a risk weight of 75%, actually higher than the 50% risk weight for banks. Current and non-junior real estate loans over 20% of assets would also have higher risk weights than provided for banks. Also, credit union commercial loans over 50% of assets would have a risk weight of 150% while the weighting for bank commercial loans over 50% of assets could be as low as 100%. These risk weights should be adjusted downward to levels no more than those in place for banks as credit unions certainly do not have higher levels of risk associated with holding these assets. Lowering risk weights for higher concentrations of real estate and commercial loans would imply lower risk weights for lower concentrations of these loans compared to bank risk-weights, but this is entirely appropriate given lower loss rates at credit unions.

We support the proposed treatment of consolidated credit union service organization (CUSO) investments and loans in which no separate risk weighting would apply. The risk weight for unconsolidated CUSO investments, though, is still too high and should be the same as for CUSO loans, which is 100% under RBC2.

In addition, we believe the 250% risk weighting for mortgage servicing, which was unchanged from the first proposal and is the same as for banks, is too high and should be significantly lower in any final RBC2.

CUNA also does not support the 300% risk weighting for publicly traded equity investments which should be much lower so that credit unions will not be unduly limited in their investments for employee benefit funding. We also urge NCUA to assign a risk weight of no more than 100% to charitable donation account investments to help encourage credit unions to continue supporting charitable endeavors, such as the National Credit Union Foundation.

We are also concerned about the definition of the Mortgage Partnership Finance (MPF) Program.[7] As proposed, the definition could be construed as limiting the benefits of the risk based capital treatment only to those credit unions that service their MPF loans, but not those that choose to sell the loans servicing-released. Whether or not credit unions service their mortgage loans does not alter their credit enhancement obligation in any way. We urge NCUA to remove the words, “and servicing them” from the definition of the MPF Program. We also recommend adding language to clarify that the definition of the MPF Program does not apply to the Mortgage Purchase Program (MPP), a secondary market alternative offered by certain Federal Home Loan Banks that achieves credit enhancement by creating a contingent asset for the credit union participant, in contrast to the contingent liability obligation created under the MPF Program. Since the purpose of the risk based capital requirements for off-balance sheet activities is to ensure credit unions hold capital against recourse risk, and MPP loans do not have such risk, MPP loans should fall outside of the definition of the MPF Program.

[7] 80 FR 4429-30.

VII. The Treatment of Goodwill and Other Intangible Assets Needs Additional Improvement

In the original proposal, goodwill and other intangible assets (OIA) would have been excluded from the numerator of the risk-based capital ratio. In RBC2, a subset of goodwill and OIA could be retained in the numerator of the RBC ratio until 2025. That subset would be limited to goodwill and OIA that arise from "supervisory" mergers prior to one month after publication of the final rule. Supervisory mergers would be broadly defined as assisted mergers, emergency mergers, or mergers where the NCUA or state supervisory authority selected the surviving credit union.

The retention of goodwill and OIA in the RBC numerator until 2025 is an improvement over the original proposal, but does not go nearly far enough. CUNA believes a strong case can be made for the inclusion of all goodwill and OIA in the numerator so long as these intangible assets meet Generally Accepted Accounting Principles (GAAP) requirements, i.e., are subjected to annual goodwill impairment testing. The exclusion of non-supervisory goodwill from the numerator will discourage some well managed and well-capitalized credit unions from participating in mergers, and many mergers serve to benefit the members of both the surviving and non-surviving credit union. Similarly, mergers can also have a favorable influence on safety and soundness – producing institutions that in combination have stronger financials and are able to weather more extreme economic swings. In some cases such mergers undoubtedly serve to head off what might ultimately become a supervisory combination.

In recognition that goodwill and OIA may not be available to cover losses in the event of a liquidation, but also accounting for the fact that GAAP goodwill is very unlikely itself to cause a credit union to fail, as an alternative, the final rule might limit the retention of non-supervisory goodwill and OIA in the numerator of the RBC ratio for those credit unions that are well capitalized on the basis of the net worth ratio.

At a minimum going forward non-supervisory goodwill that meets annual impairment testing should be retained in the numerator over a ten-year phase out period. In other words, after any future merger, the amount of any resulting goodwill or OIA that could be included in the numerator of the RBC ratio would be reduced by one tenth each year for ten years.

Regardless of whether or not non-supervisory goodwill is permitted in the numerator, CUNA strongly believes that all previous supervisory goodwill should be grandfathered without time limit, subject to regular impairment testing. There are three reasons for this. First, those credit unions that engaged in such transactions almost certainly reduced insurance losses to the share insurance fund, and should not be penalized after the fact. Second, they did so with an understanding of current rules at that time. Many of these transactions would likely not have occurred had the proposed rules been known, i.e., no longer counting this goodwill at some point in the future would be changing the rules midstream. Finally, the amount of previous supervisory goodwill is a known, fixed, and relatively small quantity. Only 20 credit unions with more than $100 million in assets have goodwill amounting to more than 5% of net worth, and the average goodwill to net worth ratio at these credit unions is just 12.8%. Supervisory goodwill likely represents no more than three quarters of that goodwill, i.e., approximately 10% of net worth. Considering future growth, that supervisory goodwill will decline in proportion to net worth and assets going forward, and grandfathering it would protect those credit unions that in the past reduced NCUSIF resolution costs, from a cliff reduction in their RBC ratios in the future.

VIII. NCUA Should Give Credit Unions an Option to Provide the Additional Call Report Information Required by RBC2

The proposed rule will require several changes to the Call Report in order to collect information on a number of new data elements provided in the proposal. The proposed changes will require credit unions to provide more detail regarding information that is presently reported on the Call Report and to provide new information that presently is not required.

While CUNA does not oppose the proposed additional data collection through the Call Report, we urge NCUA to consider an alternative to making changes that will affect all reporting credit unions. Specifically, we ask NCUA to consider an approach where credit unions will have the *option* of providing the additional, detailed information provided in the proposal. Such an approach could be accomplished by simply including additional optional data fields within the Call Report. It is our understanding that FDIC employs such an approach and we ask NCUA to consult with its fellow regulators for insight into an alternative to the current proposed changes to the Call Report.

In the Supplemental Information to the proposal, NCUA states that, "The Call Report changes prompted by this proposed rule are the kind that would easily be handled as part of the normal and routine maintenance of a credit union's data reporting system." We encourage NCUA to recognize that any and all changes required of a credit union require the expenditure of resources. In a time when many credit unions are struggling to comply with existing rules from NCUA and other regulators, we urge NCUA to consider any alternatives that will reduce the burden RBC2 will impose.

IX. NCUA Should Permit the Use of Supplemental Capital for the Purposes of this Proposal and Should Strongly Advocate for Statutory Capital Reform that Includes Supplemental Capital for the Purposes of Prompt Corrective Action

In our comment letter on RBC1, CUNA urged NCUA to allow the use of supplemental capital for any complex federally insured credit union to meet its RBC requirements. As discussed below, NCUA has the authority to permit supplemental capital for RBC purposes, and we believe NCUA should include such a provision if a final RBC2 rule is approved.

While supplemental capital cannot be included in net worth for most credit unions without a change in federal law, there is nothing in the FCU Act or GAAP that prevents NCUA from including supplemental capital in the numerator of the risk-based capital ratio for RBC, which already includes items that are not part of net worth.

We do not think NCUA needs to be overly prescriptive in permitting supplemental capital for RBC purposes. NCUA has already authorized certificates of indebtedness, which have been treated as loans from holders to their credit unions, generally with an interest rate paid to the holders. NCUA should reference the use of these instruments to meet RBC requirements for federal credit unions and, where permitted, for state chartered credit unions. Adequate disclosures should be provided by the credit union to the holder before the proceeds are accepted, but the timing or content of the disclosures need not be complicated. The disclosures should be clear and simple, to help ensure the members' interests are protected and should focus on plainly describing the nature and terms of the instruments. In addition, suitability requirements may be appropriate.

Further, we strongly encourage NCUA to aggressively pursue the enactment of legislation that would authorize the use of supplemental capital as net worth for the purposes of prompt corrective action. We note NCUA has long supported such legislation and we encourage the Board to actively advocate for its enactment.

X. A Separate Interest Rate Risk Rule Is Unnecessary Because Examiners Have Sufficient Tools to Supervise Interest Rate Risk

NCUA's revised RBC proposal contains what is essentially an implied Advance Notice of Proposed Rulemaking (ANPR) on interest rate risk (IRR)—suggesting that a separate IRR rule is needed. NCUA believes such a standard should be based on a comprehensive balance sheet measure, like net economic value, that takes into account offsetting risk effects between assets and liabilities (including benefits from derivative transactions). The stated intent of this measure would be to assess IRR consistently and transparently across all asset and liability categories, to address both rising and falling rate scenarios, and to supplement the supervisory process with a measure calibrated to address those institutions deemed by supervisory authorities to be severe outliers.

CUNA strongly disagrees with the notion that a separate IRR standard is needed to reasonably account for IRR at credit unions. Over the last several years, NCUA has issued numerous rules and letters addressing the issue of interest rate risk. For example, on September 30, 2012, the NCUA Board's final interest rate risk rule took effect. The rule imposes different requirements on federally insured credit unions depending on their asset size. Such requirements include the development and adoption of a written policy on IRR management and a program to effectively implement that policy as part of their asset-liability management responsibilities.

The guidance provided in the appendix to the IRR rule describes best practices for credit unions to consider as they write their IRR policy and construct IRR management programs. It deals with the responsibilities of boards and management, addresses IRR measurement and monitoring, internal controls, and the integration of IRR results into a credit union's decision making. The guidance also provides additional considerations if a credit union is large with complex or high-risk balance sheets. This alone should be the basis of NCUA's efforts to manage IRR concerns.

There is absolutely no need to burden the overwhelming majority of credit unions—those that are clearly not severe IRR outliers—with a new and complicated one-size-fits-all IRR approach. Instead, NCUA's focus should be squarely on the exceedingly small number of institutions that might be considered severe outliers. NCUA can easily identify severe outliers in the supervisory process—and undoubtedly has done so already. Due to the unique issues that cause each institution to be viewed as severe outliers, NCUA should concentrate resources on them separately in the supervisory process.

To this end we suggest that NCUA—prior to releasing a proposed IRR rule—form an advisory group consisting of a broad cross-section of credit unions. This advisory group should be tasked with developing a call-report-based "severe outlier identifier model." Using mostly existing call report data, the model would serve as an identification tool that evaluates each credit union's assets, liabilities, and all hedging positions that assist in managing risk exposures. Any credit union that "passes" using the model's identification rubric would be deemed to have only low-to-moderate IRR exposure and would not be subject to a standard comprehensive balance sheet model in the supervisory process. In these cases, each credit union's existing approach to IRR would be considered totally sufficient. As noted above, we expect the overwhelming majority of complex credit unions would not be selected by the designated model.

Importantly, a credit union that fails to pass using the tool's selection rubric would automatically be viewed as a "potential severe outlier." In these cases, the identification model would simply raise a "yellow flag" – requiring more detailed analysis and dialogue with supervisory authorities within the examination process. In essence this would be a resource allocation tool which would engage NCUA's Capital Markets/ALM specialists who would more closely evaluate each potential severe outlier.

Following this interaction an even smaller net number of actual "severe outliers" would be identified. These credit unions could be subjected to varying degrees of enforcement actions until they no longer were identified as severe outliers, or otherwise demonstrated to examiners that their interest risk was appropriately measure and managed.

This approach would be consistent with that which has been adopted by the banking regulators. As noted in our original comment letter, the banking industry's Basel requirements use a "three pillars" approach. Banking regulators address IRR in the "second pillar"—within the supervisory review process—in recognition of the fact that IRR is best addressed through policies, procedures and robust measurement systems. Banks are not subject to a standardized, quantified IRR rule—instead bank regulators essentially use the supervisory process to identify institutions of particular concern.

In any case, complex credit unions should not to be subject to layers of new IRR regulation disproportionate to their exposure to this risk.

It bears repeating—as noted in our previous comment letter—history has shown that credit union exposure to IRR is modest and credit unions have an enviable record of astute IRR management, continually demonstrating their ability to adequately manage, monitor and control such risk. For example, at the beginning of 2004, one-third of all credit unions with $50 million or more in total assets reported a Net Long-Term asset ratio exceeding 30% of total assets. In all, 170 of these credit unions reported a ratio between 40% and 50% of total assets and 83 reported a ratio that exceeded 50% of total assets.

Beginning in June of 2004 the Federal Reserve began to raise its short-term interest rate target and by July 2006 the Federal Funds interest rate had increased by roughly 425 basis points to a monthly average of 5.24%.

Despite this substantial market interest rate shock, we are unable to identify—either through material loss reviews (MLRs) or by other means—any strain on the NCUSIF caused by natural person credit union exposure to IRR. The NCUSIF ratio actually increased over the period from $1.27 per $100 in insured shares at the start of 2004 to $1.31 per $100 at year-end 2006. Similarly, we are unable to identify any natural person credit union with over $50 million in assets that failed as a result of too-high exposure to IRR.

XI. Implementation Should Be Delayed to 2021 to Coincide With the Termination of the Corporate Stabilization Fund

We appreciate that NCUA has proposed a significant delay in the implementation of RBC2, but we encourage the agency to delay implementation even further—until 2021—to coincide with the termination of the corporate stabilization fund, at which time credit unions will receive refunds. The refunds will be important to those credit unions that will need to increase capital levels in order to comply with RBC2.

XII. Conclusion

On behalf of America's credit unions and their members, thank you very much for the opportunity to provide comments on this proposed rule. As stated, we believe the proposal is fundamentally flawed and, in certain areas, exceeds NCUA's statutory authority. We urge NCUA to withdraw the proposal and, in lieu of that, we strongly encourage NCUA to make substantial improvements to the proposal consistent with our comments herein.

Sincerely,

Jim Nussle