April 17, 2015

Elements Financial Federal Credit Union
225 S. East Street, #300
Indianapolis, IN 46202

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

Dear Mr. Poliquin:

I am writing this letter on behalf of the members of Elements Financial Federal Credit Union, the Board of Directors and management regarding the NCUA's amended proposal for Risk-Based Capital (RBC2).

Elements Financial appreciates the NCUA's efforts involved in reworking the previous version of the rule. While we do not believe the additional rule will truly enhance the safety and soundness of the credit union industry, we believe we understand the NCUA's position on this topic.

The updated version of the proposed Risk-Based Capital (RBC2) rule still raises several issues which require deeper collective conversation within the industry. This communication will focus on five items of concern:

- The need for a new RBC rule
- Capital Adequacy
- Risk Weights
- Definition of "Complex" credit union
- Regulatory Burden v. Member Focus

The need for a new RBC rule

There seems to be a question regarding the authority of the regulator to enact the new rule – even the NCUA Board Members have different opinions on this. RBC2 provides the Regulator with broad discretionary power to impose sanctions on credit unions with no provision for independent review or appeal. It would make sense for our democratically elected U.S. Congress to write the rule, as there would be no question regarding their authority to do so.

The NCUA Board vote for RBC2 was split 2-1, with both sides providing legal opinions to support their case. It would seem that if a rule was so obviously needed and appropriate, the Board vote would have been unanimous.

The NCUA justifies the RBC2 proposal by the following:

1) Create a comparable RBC system for banks and credit unions
2) Require credit unions that take on more risk to hold more capital
3) A response to General Accounting Office recommendation

The credit union system weathered the recent financial crisis and has performed well as the nation has worked its way out of crisis mode. There is no evidence credit unions were undercapitalized or if RBC2 was in place at the time, that there would have been any significant reduction in insurance losses to the NCUSIF. Additionally, while the Federal Credit Union Act compels the NCUA to create a RBC requirement comparable to the bank system, the Act also requires the NCUA to recognize the unique nature of credit unions. As a constituent, it feels like the NCUA is responding to political arm-twisting rather than protecting its credit unions.

The NCUA has stated the changes made to the original Risk Based Capital proposal limited the credit unions directly impacted by the rule from 199 to 19. If this is accurate, one has to wonder if the rule is necessary. If the credit union industry has 19 credit unions that are deemed to be at risk with RBC2, is it worth the time and expense involved for both the regulator and the other 1,500 credit unions impacted by RBC2? The NCUA will spend millions of dollars over the next several years to enact this rule. As an option, the regulator could spend more time with the 19 credit unions it deems risky rather than making the change for all the other credit unions which seem to be managing the risk within their respective balance sheets more effectively.

Capital Adequacy

The new proposal leaves room for the NCUA to require credit unions to hold higher capital levels than the rule may require. The language within RBC2 would require a credit union to hold capital commensurate with the risks on its balance sheet, "notwithstanding the requirements" of RBC2 and PCA net worth requirements. This would allow an NCUA Examiner to consider a credit union's internal desired capital assessment and planning as a standard for examination and supervision.

Our credit union appreciates the removal of the Individual Minimum Capital Requirement (IMCR) language included in RBC1 where an Examiner could have imposed additional capital requirements on a credit union on a case by case basis. However, RBC2 would continue the authority of the Regulator to reclassify a credit union and potentially require the credit union to hold additional capital or face supervisory actions due to safety and soundness concerns. Our credit union opposes the capital adequacy plan requirements in RBC2.

If the rule math doesn't work, why should it be implemented? Our credit union is opposed to creating a rule that already has a built-in workaround: by creating flexibility to require a credit union to hold even more capital than the rule dictates, the Regulator has already conceded the proposed rule may not work well.

Additionally, while the NCUA states only 19 credit unions will be impacted by RBC2, there is likely to be a high number of credit unions that will be near the threshold and will be compelled to hold more capital as a buffer.

Representatives from the NCUA have stated credit unions do not have to maintain a large buffer above the well-capitalized limit. However, well-run credit unions understand there are risks beyond their control and will always work with a buffer to avoid falling into a PCA category that is below well-capitalized.

As an example, while 7% is the bogey for well-capitalized status, all parties can agree that most credit unions work to operate at a capital level that is significantly higher than 7% to avoid regulatory scrutiny. Credit unions will need to hold additional capital, which may impede an organization's ability to provide convenience and value for the membership and slow market share growth.

Risk-Weights

The original proposal was attempting to cobble together a formula that melded interest rate risk, credit risk, and concentration risk. In RBC2, the NCUA spent much time in improving the risk-weight factors.

The NCUA addressed a long list of risk-weights but there remain several which require higher weighting than banks. The risk-weights for CUSO investments remain very high, which could impair a credit union's willingness and/or ability to own and operate a CUSO.

The 150% risk-weighting assigned to investments in CUSOs seems excessive. There is no distinction made as to the nature of the CUSO operations being evaluated, nor to the dollar level of investment. This seems entirely arbitrary as the NCUA has not provided historical support within the proposal for the risk-weight. CUSOs have been utilized by credit unions for numerous years as a way to provide expanded value-added services to members in both a cost-effective and profitable manner.

In general, the risk-weighting for credit unions should be lower than the risk-weighting for commercial banks for comparable products. Historically, credit union loan losses have been significantly lower than banks, so from a credit perspective, it makes sense to reflect this difference in the form of a lower risk-weight for credit unions.

Definition of Complex Credit Union

The proposed RBC2 rule applies only to "complex" credit unions, as defined by the NCUA.

The NCUA recently made the decision to classify "complex" as a credit union with assets of at least $100 million, up from $50 million. Our credit union has some concerns with the approach of defining the complexity of an organization simply based upon asset size. We recognize as a Regulator, there needs to be some means of efficiency and cutoffs to better classify risk and commensurate supervisory oversight. However, we believe the NCUA will better serve the industry by defining "complex" with factors such as deposit account types, services to members, loan and investment types, along with portfolio composition. This approach is less cookie-cutter and is more consistent with the spirit of the Federal Credit Union Act which requires the Regulator to consider "the portfolio of assets and liabilities" of credit unions when determining whether they are "complex."

Is the $100 million threshold going to be indexed to account for inflation? That is, over time there will more credit unions impacted by the rule as smaller credit unions grow assets. If there is no indexing formula, theoretically, all credit unions at some point will be subject to the RBC2 rule. Is this the NCUA's plan? Will any "small" credit unions remain?

As credit unions determine how RBC2 is administered, it is possible the rule may cause smaller credit unions to grow more slowly as they get closer to the $100 million threshold to avoid the additional regulatory requirements and scrutiny.

Regulatory Burden v. Member Focus

As credit unions work to manage their shops to a particular mathematical hurdle, I find it likely the NCUA will change or alter the factors over time. While we can poke at numerous inconsistencies within the risk-weights, the NCUA likely cannot argue with any degree of certainty how or why the factors are correct.

It is possible that any changes made to the factors in the future could have a positive or negative impact to credit unions. However, as the rules change, credit unions may spend more time working to manage to a complex ratio rather than working to provide value-added services to the membership. The regulatory burden may outweigh any perceived gains related to safety and soundness because our eye may be distracted from what we are chartered to do – serve our members.

As mentioned, the NCUA will spend millions of dollars to update the regulatory reports and credit union staff will spend significantly more time completing the reporting. The Regulator has spent six figures merely to verify their legal right to create a risk-based capital rule.

As one ponders the additional time and money spent on this endeavor by the regulator as well as individual credit unions, it makes even less sense to enact the rule. While our organization appreciates the Agency's efforts to design a risk-weighted matrix to protect the Share Insurance Fund, we see no evidence this proposed rule will provide substantial value to the industry. Risk-based capital did not prevent the 2008 financial crisis from happening, as the predominant issue was liquidity. The current system that divides tangible net worth into total assets has been simple and effective.

Obviously, the NCUA has listened to credit unions as it made modifications to the original rule. While Elements Financial believes the rule is unnecessary and will be ineffective, our organization does value the relationship with the Regulator and appreciates the process the NCUA has created to allow individual credit unions to voice concerns related to new rules and regulations.

Thank you for your consideration,

Joseph R. Hasto, Jr.

Chief Financial Officer

Elements Financial Federal Credit Union

jhasto@elements.org

317-524-5051