From:	NRFCU CEO
To:	_Regulatory Comments
Cc:	"Sharon Lindeman"
Subject:	comments to NCUA proposed RBC2
Date:	Tuesday, April 21, 2015 4:52:49 PM

RE: RBC2 Proposal

Analysis, Conclusion & Recommendations:

I am addressing this analysis in two parts-how this proposal affects my credit union [<$100M], and the effect it will have on credit unions greater than $100M.

Northern Redwood FCU

Although my credit union is less than the proposed $100 million [M] threshold, I nevertheless used the RBC2 model prepared by CUNA to determine where my credit union would fit. Using the 12/31/14 financial information provided in the model, it was estimated that our RBC2 capital would arrive at 14.93%, and our standard capital ratio being at 8.0%, but it did leave me with some questions.

I examined each of the categories within the model as it pertains to my credit union in determining our specific RBC2 capital position and came up with the following questions.

1. Cash items, the first category of the denominator portion of the equation; why does the NCUA assume that all U.S. federally insured depository institutions are UNINSURED? Is this an error in the model? All our deposits/investments with U.S. federally insured deposit institutions are in fact insured, and should not be subject to the 20% weight factor. <u>Treating these deposits as uninsured increases our denominator figure by the 20%, or $1.3 million, and has the effect of reducing my RBC2 position from 17.80% to the calculated 14.93% as I noted above</u>.
2. Loans [by general loan type], again in the denominator portion of the model for secured consumer loans is weighted at 75%. The analysis provided by CUNA notes that it is higher than commercial banks, however, <u>I believe that CUNA may have reversed the percentage, and in fact commercial banks have a weight of 100% and credit unions are lower at 75% weight factor</u>. I could be wrong, but the information provided on page 7 of the CUNA Summary on RBC2 indicates what I have written.
3. Two lines below the secured consumer loans noted above, non-current consumer loans are weighted at 150%? I don't understand why this is weighted so high. If I have a ten thousand dollar loss, I don't write off $15,000. <u>I question this weight factor</u>.
4. Continuing the Loans section, current commercial loans less than 50% of asset is weighted at 100%. We approve commercial loans and all of our loans are secured by commercial vehicles which are not uncommon in our area. I would prefer that the NCUA consider an additional section for secured commercial loans with perhaps a 50-75% weight factor, just as in secured consumer loans. I understand the rationale for unsecured loans, <u>but where there is a market for certain types of commercial vehicles, a lesser weight makes more sense</u>.
5. Lastly, expanding the delinquency loans from 60 days to 90 days has more risk and

greater exposure to potential loss. I do not agree with CUNA on increasing the limit to 90 days.

6. NCUA's new elements in the definition of first lien, residential real estate for purposes of RBC only. I believe the proposal by the Consumer Financial Protection Bureau's Ability to Repay [ATR] rule for first liens is ridiculous. As CUNA's assessment states, credit unions already comply with this during the regular credit analysis process in determining a member's ability to repay the lien and any other lien or obligation. The size of the mortgage portfolio does not matter; all credit unions essentially analyze this process and no regulation is required here. This is an example of NCUA regulatory over-reach.

Our credit union is also engaged in mortgage lending, indirect automobile lending, however our mortgage portfolio is now less than 30% of our total loan portfolio, and I don't see this as an issue with us. We reduced our exposure in this area over the past four years, when mortgage loans comprised 65% of our portfolio, but is now at a much more acceptable level in terms of interest rate risk, and loan concentration risk. Our indirect automobile lending is just over 40% of our total loan portfolio, and are enjoying a high loan yield of just over 8% in this category with zero delinquents and zero losses.

Overall, I don't have an issue with most of the targets being recommended in the model by the NCUA or what CUNA has outlined and are proposing, except for the ones noted above and in the next section below, and I believe I understand what the NCUA's motive is in managing your assets, forcing, no, providing management a large incentive to understand the risks associated with each venture entered into and the potential risk to that particular financial institution. If anything, I would recommend that credit unions not obligated under this RBC2 proposal to study the model and plan their asset structure accordingly in order to manage credit union assets and minimize risk so that as they approach the approved term "complex," they are already prepared.

As a trained financial engineer, I have long utilized "The DuPont" financial model [no longer taught in University?] in structuring the asset/liability management for all my credit unions in order to optimize yields, eliminate or greatly reduce asset concentrations, and reduce interest rate risk as much as possible. Commercial banks are more complex but also have greater variety to their investment modeling, and can actually eliminate all interest rate risk by employing a complex mathematical formula provided under the DuPont model, but does not apply to credit unions [almost all of them] because of legislative investment restrictions.

Credit Unions over $100 million in Assets:

The remaining categories in the model exhibited much complexness requiring great expertise, and frankly, I cannot even foresee most credit unions over the $100 million asset mark engaged in many of these categories, let alone any credit union below $100M. Again, referencing the RBC2 model, I see rather, much larger credit unions engaging in many of the references in the model, and would more easily be defined as a complex credit union. I am of the belief that the limit the NCUA proposes be increased to $500 million in total assets, and/or being engaged in over 50% of all the categories noted in the model, especially the investment section. Please see below for more of an explanation.

This then leads me to the definition of what the NCUA has defined as a "**complex**" credit union. I am NOT in agreement with the NCUA that credit unions over $100 million in assets are automatically defined as complex. Rather than an arbitrary figure of $100 million in assets, I would observe that ANY credit union engaged in "**many**" of the categories exhibited in the model would lend themselves to being labeled complex. I don't view this from an asset size credit union, but more of a credit union engaged in a number of the categories, in varying combinations, AND, also having qualified and experienced primary and secondary staff backup to sustain these involvements should drastic changes in staffing occur. I am of the belief that the NCUA needs to revisit this definition, look at the complexity of programs involved in the model, credit union staffing, asset size, and then classify a credit union as "complex." But then we need to define "**many**." This is very difficult, but given what I observed in the proposed NCUA model, and the examples CUNA provided in their list, that perhaps engaging in over 50% of the total programs provided in the model, especially in the Investment category, would be a good start in determining a proper definition. More analysis needs to be performed here by the NCUA. With an implementation date of January 2019, the NCUA has more than sufficient time to do a deeper analysis before implementation any RBC2 regulation.

Interest Rate Risk [IRR] should be a major concern throughout the industry and is something that the NCUA should continue to monitor, considering that we are on the cusp of a rising interest rate environment. Many credit unions have investments extending beyond three to ten years in maturities in order to obtain yield, and should require more capital weights in the NCUA model to help mitigate IRR and a potential decline in capital. Placing greater weights in investment categories exceeding three [3], five [5], and ten years should have different and increasing weight structure in helping to mitigate risk. But even here, the NCUA must look at the overall strategy of any credit union when dealing with "held to maturity," and having investments "available for sale," before determining proper weight structures in formulating IRR policy. What does the other side of the Credit Union balance sheet look like? Does the Credit Union offer mid and long term certificate investments that do not reprice as frequently as regular shares that help mitigate reprising assets amounts? This is complex and there is no one plan fitting the bill for all credit unions.

There is always the problem of over-regulating an industry to the point where rules and regulations strangle an industry to the point killing the industry. I am not aware of the professional backgrounds of the individuals who makes decisions at the board level, and wonder if they even have a banking or credit union executive and line management background. If the industry experience is not there at that level, I would strongly recommend industry input from qualified credit union management from all levels nationally in providing input to the NCUA as we are with this RB2 proposal. Most of the Credit Union industry is comprised of credit unions less than $50M with substantially less in the over $100M, and even more rare in the over $1B in total assets as a percentage of all credit unions. Most credit unions don't require this type of regulatory supervision; perhaps only those well over $500M in assets, perhaps!

I believe CUNA's concern "*regarding maintaining capital commensurate with the level and nature of all its risk*," as quoted in their analysis is valid. I believe this does leave it open for examiners to demand more and more capital as they are never satisfied, and in effect, micro-managing a financial institution where they have no experience in nor any over responsibility over. I am also dubious of the NCUA "providing" examiner guidance in this area. I find that I have to explain much to examiners because of their lack of professional line experience and knowledge in many matters. I may be stretching it a little if I bring up Enron and the takedown of the CPA firm, Arthur Anderson, as an example, as the CPA firm lacked the experience to understand what was taking place with Enron. My experience is examiners are "by the fact" only, and if it's not in policy, it doesn't exist type attitude and intuitiveness is a foreign word to them.

I do not entirely agree with CUNA that any new RBC rule is not needed, especially as large and "complex" credit unions commence engaging in complex financial strategies that require an advanced and specific level of expertise. I believe the NCUA needs to revisit this proposed requirement, and compartmentalize it in three asset categories as I suggested above, but certainly leave the less than $100M credit union alone, and perhaps raise the RBC bar to $500M.

On the other hand, the NCUA essentially ignored its own industry for decades, and as a result of the 2008-9 collapse drastically affecting the natural person and corporate credit union structure, all of us in the industry are now having to be the recipient of excess and burdensome regulatory processes since then, that should have been done over the decades instead of the past five years, placing a tremendous amount of pressure on smaller credit unions who don't have the personnel asset to distribute the work load of excess regulatory burdens placed upon them/us.

Respectfully,

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"The world of your imagination is the world of your eternity." **William Blake, English Poet & Painter, August 12, 1827.**
"… Two roads diverged in a wood, and I - I took the one less traveled by, and that has made all the difference."
Robert Frost, Poet, 1916 [Mountain Interval collection]