LAKE TRUST
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April 23, 2015

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

Comments on Proposed Revised Rule: PCA – Risk-Based Capital, RIN3133-AD77

Dear Mr. Poliquin:

I am writing on behalf of Lake Trust Credit Union, which serves 35 counties in Michigan, and has 169,000 Members and $1.6 billion in assets. Lake Trust Credit Union appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposed revised rule, Prompt Corrective Action - Risk-Based Capital (RBC2).

The revised proposal represents a significant improvement over the original proposal issued last year, but we question whether the rule is actually needed. We address our concerns regarding this in the first section.

In subsequent sections, we address the need for supplementary capital, additional changes related to the numerator of RBC2 related to goodwill and other intangible assets and the National Credit Union Share Insurance Fund (NCUSIF) deposit, additional changes related to risk-weightings of certain assets and call report information.

Last we provide our thoughts regarding new or additional interest rate risk rules. We believe that the current rules are more than adequate to manage this risk.

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Is the Risk Based Capital Rule Really Needed and Does NCUA Have the Statutory Authority to Issue the Rule?

Natural person credit unions performed very well during the recent financial crisis which started in 2007 and was the worst since the Great Depression. The NCUSIF weathered the downturn extremely well with the fund balance never falling below its historical range of 1.20% to 1.30% and NCUSIF only assessing premiums to natural person credit unions twice throughout that period, both times for relatively small amounts. From 2007 through 2012, only 123 credit unions failed and the remainder of the credit unions weathered this difficult period, with the industry maintaining net worth ratios in excess of 10% for every year from 2007 through 2012, except for the 9.89% ratio in 2009.

Based on the above information, the industry made it through the financial crisis with strong net worth ratios, required NCUSIF capital ratios, limited NCUSIF assessments to natural person credit unions, and a small number of credit union failures. So one needs to ask the question whether this new risk-based capital rule is really required.

We have also heard from the Credit Union National Association (CUNA) that their belief is that the National Credit Union Administration (NCUA) does not have the statutory authority to issue this risk based capital rule to determine whether a credit union is well capitalized and we agree with their thoughts. We also note that one NCUA Board member has also questioned whether NCUA has the legal authority to establish separate risk based net worth requirements.

We do appreciate that NCUA has reduced the well-capitalized risk-based capital requirement from 10.5% to 10% but again ask the following questions: is the rule required given how the industry made it through the recent deep financial crisis and does NCUA have the statutory authority to implement the rule.

Need for Supplementary Capital

We repeat our concern from our first comment letter. The introduction of a risk-based capital system requires more options for all credit unions to raise supplemental capital. In conjunction with or prior to the implementation of the new risk based capital system, we encourage NCUA to implement supplemental capital options that count toward risk based capital and if possible net worth. Supplemental capital will provide an important tool for those credit unions that will no longer be well capitalized as a result of this rule. It will also provide strategic options for credit unions to raise capital to allow them to manage their future risk based capital should their strategic plans cause their risk based capital to fall into the adequately capitalized category.

Additional Improvements Needed for Goodwill and Other Intangible Assets

We appreciate that the NCUA has made some changes by allowing goodwill and other intangible assets arising from supervisory mergers that occur up to one month after the final rule is published to remain in the numerator of the risk based capital ratio until 2025. However, we feel that this change does not go far enough.

Credit unions with these assets on their books undertake stringent testing on the assets each year and if the assets are impaired, an appropriate charge would be made through the income statement. In addition, a core deposit intangible asset (related to the credit union's core deposits) is amortized through the income statement based on the average lives of the related core deposits. This expense is one that only credit unions involved in acquisitions or mergers have in their results.

We continue to believe that this proposed rule related to goodwill and other intangible assets being deducted from risk based capital is likely to have a chilling effect on mergers and especially on transactions with NCUA related to troubled credit unions. If credit unions are less able to assist NCUA with taking over troubled credit unions, then there will likely be more losses that the NCUSIF will have to absorb and then potentially more NCUSIF assessments made on natural person credit unions, creating more potentially troubled credit unions. In our own case, it is likely that we would not have done an assisted merger with Huron River in 2007 (or if we did, the cost to the NCUSIF would have been higher) nor the merger that created Lake Trust due to the impact of goodwill and other intangible assets on the risk based capital ratio. And clearly these mergers were good for members of Lake Trust and Lake Trust is a much stronger credit union today.

We believe that all goodwill and other intangible assets, whether from supervisory or non-supervisory actions and whether occurring in the past or in the future, should continue to be included in risk based capital or in other words, the required deducting of these amounts from risk based capital should be eliminated from the rule. But at a minimum, we believe that any new goodwill and other intangible assets should be retained in the numerator for a minimum of ten years after any merger or acquisition transaction. We would also encourage NCUA to consider grandfathering any previous supervisory goodwill and other intangible assets to be permanently retained in the numerator.

Reduction of Risk Based Capital for NCUSIF Deposit

We appreciate the concerns raised by NCUA regarding the double counting of the NCUSIF deposit on the balance sheets of both NCUSIF and natural person credit unions. However, we still believe that this deposit should not be deducted from risk-based capital (the numerator).

The NCUSIF endured the recent deep recession with only two minor NCUSIF assessments (totaling 0.1715% of insured shares) related to natural person credit unions. The major NCUA assessments came from issues with corporate credit unions, resulting in the creation of the Corporate Stabilization Fund and annual corporate assessments from 2009 through 2013 (totaling 0.662% of insured shares over those five years). It now appears that no future corporate assessments will occur and that credit unions will likely receive refunds when the fund terminates in 2021. Also the rules related to corporate credit unions are more stringent, likely eliminating or reducing the potential for such an event to occur in the future.

It also appears that NCUA would like to utilize a risk based premium assessment model as well as requiring a higher equity ratio for the NCUSIF, based on a recently obtained white paper and comments made in writing to the Senate Banking Committee in February 2015. These actions, if implemented, would likely make the NCUSIF deposit even stronger and less likely to become impaired.

Risk Weightings of Assets (in the Denominator)

We commend NCUA for listening to its constituents and making a number of changes related to risk weightings. We would like NCUA to once again consider lowering certain additional risk weightings discussed below.

Equity investments in credit union service organizations (CUSOs) should be lowered to 100%, the same as loans to CUSOs. We feel that investments in CUSOs are no more risky than loans to CUSOs. In cases where we have larger investments in a CUSO we typically have a voice in the operation of that CUSO, which allows us to ensure that the CUSO is operated in a safe and sound manner. Also, generally accepted accounting principles would require us to mark down any investment in a CUSO that is deemed to be impaired.

Investments for employee benefit funding allow us to invest in securities that may not be purchased for normal investment of excess credit union funds. Since these securities are marked to market (or if supported by insurance to the cash surrender value), then placing a risk weighting of 300% does not make sense and we urge NCUA to lower this considerably so that we are not forced to reduce this type of investment.

We urge NCUA to consider lowering the weighting of mortgage servicing rights from 250% to a lower amount. Under generally accepted accounting principles, we are required to obtain appropriate market valuations of these assets and mark these assets to the lower of book or market.

We appreciate the risk weighting changes made for loans from the first proposal to this current proposal but are still concerned about some of the weightings. The current weightings for first lien residential real estate loans above 35% of assets would have a risk weight of 75%, higher than those used by banks. Also weightings for commercial loans over 50% of total assets would have a risk weight of 150%, higher than weightings for banks (which can be as low as 100%). We urge NCUA to consider lowering these weightings to no more than what is used by banks, especially in light of lower loss rates at credit unions.

Additional Call Report Information Required by RBC2

The RBC2 rules will require significant modifications to the call report in order to gather the required information. We urge NCUA to provide sufficient time for credit unions to identify how to fulfill all of these new data requirements. Normally NCUA publishes call report changes about 90 days in advance of their required implementation. We would ask that the time be extended to at least 180 days in advance of required implementation.

Additional Interest Rate Risk Rules

The current RBC2 proposal requests comments on alternative approaches that could be taken by NCUA in the future to account for interest rate risk within the prompt corrective action framework. We believe that adequate rules and requirements already exist related to managing interest rate risk and that no further rules are required.

Some of the interest rate risk management rules that have been issued over the last five years include a May 2012 Letter to Credit Unions that required a written policy and a program to effectively implement that policy be in place by September 30, 2012. This letter also provided an examination questionnaire. Interagency guidance was also issued on January 6, 2010 as well as a follow-up of frequently asked questions issued January 12, 2012. In addition, interest rate risk was made a focus of 2014 examinations (as indicated in a January 2014 letter to credit unions).

All of these activities should adequately ensure that credit unions have appropriate interest rate risk programs in place to manage their interest rate risk and ensure adequate focus is placed on this area. Adding more rules to be considered and followed would be an unneeded regulatory burden. If there are credit unions who are not properly managing their interest rate risk, these concerns should be handled through the examination process. Adding more rules will not ensure that these rules would improve management of interest rate risk at these outlier credit unions but rather would burden the majority of the credit unions who are doing a good job of managing interest rate risk.

Final Thoughts

Lake Trust thanks you for all of the changes that were implemented in the second version of the risk based capital proposal. In this letter, we have provided our thoughts on additional changes that we believe should be made if the proposed rule is implemented. However, we do not believe that the rule is necessarily required given the financial stability of the industry and the excellent way that the industry came through the great recession.

We thank you for the opportunity to comment on this revised proposed rule and for considering our views on risk based capital requirements.

David A. Snodgrass

President & CEO

Copy to:

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Michigan Members of the U.S. Congress