April 23, 2015

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

RE: Comments on Proposed Rule: Risk-Based Capital; RIN 3133-AD77

Dear Gerald Poliquin,

I am writing on behalf of the California and Nevada Credit Union Leagues (Leagues), one of the largest state trade associations for credit unions in the United States, representing the interests of approximately 400 credit unions and their 10 million members. The Leagues welcome the opportunity to provide comments to the National Credit Union Administration (NCUA) on its second proposed Risk-Based Capital rule (RBC2).

The Leagues thank the NCUA Board for listening to the more than 2,000 comment letters received on the original risk-based capital proposal and issuing a second proposed rule with significant improvements. We fervently hope the NCUA continues to be open to comments received on the second proposal.

The Leagues continue to believe that a risk-based capital (RBC) rule is not needed. Further, we believe the NCUA does not have the legal authority to implement a two-tier RBC system. For these reasons we vigorously oppose the proposal and recommend it be withdrawn. The Leagues urge the NCUA to not create unnecessary regulatory burdens for federally insured credit unions.

Absent withdrawal of the proposal, the Leagues have several concerns with the proposed rule, including the definition of complex credit unions, risk weights for credit union service organization (CUSO) investments and mortgage servicing rights, and the unfavorable treatment of non-supervisory goodwill and the share insurance fund deposits. We are especially concerned about the proposed capital adequacy requirements and its potential to require credit unions to hold capital beyond the RBC and net worth requirements.

Should the NCUA, after careful consideration and reexamination, still determine that a new RBC system is appropriate, the Leagues respectfully submit comments and recommendations to address the above concerns. In addition, we offer comments on how to account for interest rate risk and the use of supplemental capital for RBC purposes.

The Rule is Not Needed

The Leagues strongly believe the rule is unnecessary given the solid performance of natural person credit unions and the National Credit Union Share Insurance Fund (NCUSIF) during the recent financial crisis. The NCUA has estimated a cost $3.7 million to implement the rule, yet based on the agency's own analysis, of the 1455 credit unions covered by RBC2 only 19 credit unions would be required to raise additional capital. These implementation costs are extreme and unwarranted and do not outweigh any perceived benefits. If the NCUA is concerned about a few outlier credit unions that could jeopardize the NCUSIF by taking on too much risk, then we recommend the agency address risk on a case-by-case basis and not use a broad-brush approach through regulation. This proposed rule should be withdrawn and the agency should use the concepts as tools, not a rule.

No Legal Authority for a Two-Tier System

The proposed rule imposes a two-tier system with a well-capitalized requirement of 10 percent risk-based capital ratio and an adequately-capitalized requirement of 8 percent. However, the Federal Credit Union Act (12 U.S.C. §1790d(d)(2)) directs the NCUA to devise a risk-based net worth requirement to address risks against which the net worth ratio requirement to be adequately capitalized may not be sufficient.

NCUA Board Member McWatters issued a statement that in his view the NCUA does not possess the legal authority under the FCU Act to adopt a two-tier standard. The Credit Union National Association (CUNA) obtained a legal opinion that concluded the NCUA's approach is contrary to the express language of the FCU Act. In addition, former Speaker of the House Newt Gingrich and former Senate Banking Committee Chair Alfonse D'Amato, both of whom held their positions in Congress when the credit union risk based net worth (RBNW) rules were enacted, have stated that it was not the intent of Congress to permit the Board to issue two-tier RBNW regulations.

The Leagues agree with these interpretations of the FCU Act, and should the NCUA move forward with a RBC rule, we call on the NCUA to revise the proposal consistent with current law and issue a single requirement for adequately capitalized.

Definition of Complex Credit Unions

The proposed definition of "complex" credit unions is based solely on an asset size – federally insured credit unions with $100 million in assets. The Leagues oppose this approach for two reasons. First, asset size does not accurately reflect a credit union's complexity. While asset size may be one factor in assessing a credit union's complexity, it does not stand alone. The FCU Act requires the NCUA to consider "the portfolio of assets and liabilities" of credit unions. This directive should not be ignored. Second, an asset threshold divides credit unions into two classes. The credit union movement is one collaborative system and dividing the industry plays into the hands of bankers.

The Leagues recommend the NCUA consider both asset size and operational

complexity. We recommend the definition be amended to include federally insured credit unions with an asset size of $250 million or more *and* have operational complexity based on the individual credit union's portfolio of assets and liabilities. Credit unions with assets less than $250 million would not be subject to the rule.

We suggest an asset size component of $250 million or more as that is consistent with the NCUA's liquidity rule. The Liquidity and Contingency Funding Plans rule, published October 2013 (78 FR 64879) places additional requirements for credit unions with $250 million or more in assets. The NCUA established this threshold for the liquidity rule stating these credit unions "have a greater degree of interconnectedness with other market entities" and "when they experience unexpected or severe liquidity circumstances, they are more likely to adversely affect the credit union system, public perception, and the NCUSIF."

CUSO Investments

The Leagues support the proposal's revised treatment of consolidated CUSO investments and loans for which no separate risk weighting is assigned. However, we believe the proposed risk weighting for unconsolidated CUSO investments of 250% is too high. This risk weight is excessive and punitive, assumes all CUSO investments are risky, and treats all CUSOs the same.

In addition, the proposed rule assigns a risk weight of 100% for loans to CUSOs. The proposed risk weight of 250% for investments implies that investments to CUSOs are 2.5 times riskier than loans to CUSOs.

The Leagues believe this risk weight is excessive and could limit credit unions' current and future investments in CUSOs which exist to provide credit union members with innovative products and services and to create revenue streams and efficiencies for credit unions.

The Leagues recommend investments in CUSOs should carry a 100% risk weighting based on the following risk mitigating factors. First, Generally Accepted Accounting Principles (GAAP) requires credit unions to evaluate the asset for potential impairment. Second, the majority of CUSOs are Limited Liability Corporations (LLCs) and the credit union would be protected under the LLC structure. Lastly, the stated purpose of NCUA's CUSO rule, which became effective in June 2014, is to reduce risk exposure to credit unions.

Mortgage Servicing Assets

The Leagues continue to oppose the proposed 250% risk weighting for mortgage servicing rights, which is unchanged from the first proposal. Many credit unions retain the servicing rights of loans they originate in order to maintain their member relationships and this excessive risk weight could affect their ability to do so. Mortgage servicing rights are salable assets and, consistent with GAAP, they are

evaluated for potential impairment. The Leagues recommend a risk weight of 100%.

Goodwill

Under the original proposal, goodwill and other intangible assets (OIA) were deducted from equity in the RBC numerator. The Leagues recommend then and now that goodwill and OIA not be deducted.

Under RBC2, the agency proposes to allow goodwill and OIA that result from supervisory mergers to be included in the RBC numerator until 2025; all other forms of goodwill are excluded. This exclusion of non-supervisory goodwill serves as a disincentive for credit unions to participate in mergers that are in the members' best interests and stave off a supervisory merger.

The Leagues recommend that all goodwill and OIA, resulting from supervisory and non-supervisory mergers, be included in the risk-based capital (RBC) numerator, so long as they are subject to annual goodwill impairment testing under GAAP.

At a minimum, both supervisory and non-supervisory goodwill and OIA that result from *future* mergers and meet the impairment testing should be included in the RBC numerator over a ten-year phase out period, and all supervisory and non-supervisory goodwill and OIA that resulted from *previous* mergers should be grandfathered without a time limit, subject to the annual impairment testing.

NCUSIF Deposit

The proposed rule does not assign any value to credit unions' NCUSIF deposits. Including the deposit in both the numerator and denominator removes any credit for that asset – and the Leagues contend that it is an asset of the credit union. The deposit would be returned to the credit union should they disband or convert to private insurance or to a bank charter. The Leagues recommend the NCUSIF 1% deposit be treated as a credit union asset with a risk weighting of 100% or lower.

Capital Adequacy

The Leagues are very concerned that the NCUA believes the proposed rule is calibrated to be the minimum regulatory capital standard and that it is necessary to incorporate a broader regulatory provision for complex credit unions. Specifically, the proposal adds a new requirement that a "complex" credit union (a) maintain capital commensurate with the level and nature of all its risks, (b) have a process to determine its capital adequacy in light of its risk, and (c) develop a comprehensive written strategy to maintain "an appropriate level of capital." This provision would allow examiners to consider a credit union's internal desired capital assessment and planning as a standard for examination and supervision and then require the credit union to hold capital greater than the RBC and net worth requirements.

The Leagues strongly oppose this provision and reject the idea that the capital requirements are in any way the “minimum” requirements. If a credit union meets the net worth and risk-based capital requirements to be well-capitalized or adequately capitalized under the FCU Act requirements, the agency should not have the ability to require the credit union to hold additional capital. Furthermore, a credit union’s self-assessment and planning, based on their risk tolerance, should not be the standard for examination and supervision and their capital goals should not become a requirement to hold capital beyond RBC and net worth requirements. The Leagues urge the NCUA to remove the capital adequacy provisions from the proposed rule.

Interest Rate Risk:

One of the most significant changes from the original proposal was that interest rate risk (IRR) was removed from the risk weights. We applaud the NCUA for agreeing that IRR measures should be addressed on the entire balance sheet, looking at both assets and liabilities.

However, under RBC2 the NCUA requests comments on alternative approaches to account for IRR. This request for comments suggests the agency intends to address IRR in a new rule. In addition, NCUA’s Letter to Credit Unions 15-CU-01 states the agency is in the process of updating guidance to ensure IRR is assessed accurately and appropriate supervisory steps are taken for excessive IRR exposure.

The Leagues oppose the idea of a new IRR rule and believe the current IRR requirements, adopted in 2012, are sufficient. These requirements, found in NCUA’s Rules and Regulations, Part 741.3(b)(5) and Appendix B, require federally insured credit unions, as part of their asset liability management (ALM) responsibilities, to develop and adopt a written policy on IRR management and a program to effectively implement that policy. Appendix B to the final rule sets forth guidance on developing an IRR policy and an effective implementation program, which according to the NCUA, “are based on generally recognized best practices for safely and soundly managing interest rate risk.”

The Leagues strongly contend that IRR cannot be addressed with a one-size-fits-all regulation, and instead should be addressed on a case-by-case basis in the supervisory exam process, taking into account individual credit unions’ business models. The Leagues urge the NCUA to recognize that IRR and ALM are very complicated and cannot be simplified through a broad brush approach.

Should the NCUA move forward with additional guidance or rulemaking, the Leagues strongly suggest the NCUA consider not only Net Economic Value (NEV), but also Cash Flow and Earnings (Net Interest Income simulations). These financial measurements examined separately and in concert with one another provide a more accurate and complete assessment of a credit union’s IRR. The NCUA should have trained ALM/IRR specialists who understand how, in equal measure NEV, Cash Flow, and Capital is impacted by NII under the standard rate shock scenarios and how

changes in NEV impact an individual credit union's operations and financial results given the credit union's liquidity and capital position.

The Leagues also strongly recommend the NCUA create and support an environment in which a field examiner feels free to call in an ALM/IRR specialist when a first pass indicates potentially high IRR. Having an examiner who can dig deeper and evaluate all the layers, including NEV, Cash Flows, Earnings, and the credit union's business model is critical to the ALM/IRR assessment. The Leagues also maintain that examiners should give credence to experts conducting modeling and analysis; for example, when a credit union's analysis of non-maturity shares volatility supports their assumptions.

Supplemental Capital

Under RBC2, the Board declined to permit credit unions (other than low-income credit unions) to include other supplemental forms of capital in the RBC ratio numerator. However, the Board did specifically request comments on how supplemental capital can work for risk-based capital purposes.

The Leagues support the use of supplemental capital for RBC purposes and suggest that appropriate rules and guidelines are needed to acknowledge and protect the unique structure of credit unions – member-owned, member-elected boards (one member, one vote), and tax-exempt status. We recommend the NCUA utilize or expand the current supplemental capital advisory group to explore appropriate options.

The Leagues also encourage the NCUA to continue their support of legislation to allow the use of supplemental capital for RBNW and prompt corrective action requirements.

Conclusion

The Leagues urge the NCUA to withdraw the proposal as we believe it is unnecessary given the solid performance of natural person credit unions and the NCUSIF during the recent financial crisis. The estimated costs to implement the rule to address a few outliers are extreme and unwarranted. Instead, the NCUA should address risk on a case-by-case basis and not use a broad-brush approach through regulation.

Absent withdrawal of the proposal, the NCUA must ensure any final rule is sensible and lawful, establishes a single requirement for adequately capitalized, includes the use of supplemental capital for RBC purposes, and does not create unnecessary regulatory burdens.

We thank you for the opportunity to comment on the proposed rule and strongly urge the NCUA to once again consider the industry's comments, including our comments herein.

Sincerely,

Diana R. Dykstra
President and CEO
California and Nevada Credit Union Leagues

cc: CUNA, CCUL