From:	John McKenzie
To:	_Regulatory Comments
Subject:	Indiana Credit Union League Comments on Proposed Rule - PCA Risk-Based Capital
Date:	Thursday, April 23, 2015 4:25:21 PM

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

Re: Indiana Credit Union League Comments on Proposed Rule - PCA Risk-Based Capital

Dear Mr. Poliquin:

The Indiana Credit Union League (ICUL) appreciates the opportunity to submit comments on the National Credit Union Administration's proposed rule addressing risk-based capital under the Prompt Corrective Action section of NCUA's rules & regulations. The ICUL member credit unions represent 96% of assets and members of Indiana's credit unions, with those memberships totaling more than two million consumers.

The ICUL continues to support the concept of risk-based capital. We believe that a much broader overhaul of the capital regulations should occur that replaces the existing leverage and risk-based capital ratios with one risk-based ratio that is appropriately designed to recognize both the risk and the unique cooperative structure of credit unions. We appreciate the NCUA Board listening to the comments made on the initial RBC proposal and making significant changes that addressed many of the concerns expressed in the letters. While we appreciate and agree with many of the changes made; in particular the major revisions to many of the risk weights, we are still not convinced that there is a need for this regulation at this time. We would encourage NCUA to step back and revisit the overall capital regulations and develop one risk-based capital measurement that replaces the leverage ratio and current risk-based measurement. We continue to question NCUA's authority to establish a two tiered RBC requirement that exceeds adequately capitalized as the highest standard.

While the improvements to the initial proposal are appreciated, we still have ongoing concerns with this revised proposed rule. These concerns include:

- NCUA has not sufficiently demonstrated the need for this proposed rule.
- CUSO investment risk weighting is too high and does not distinguish between the differences in risk between various types of CUSOs.
- Mortgage servicing assets risk weighting is too high.
- While the revised proposal eliminated the individual minimum capital requirement that NCUA could have imposed on a credit union, we believe the capital adequacy plan requirement that is subject to supervisory review would still allow NCUA to require a higher RBC ratio for a credit union based on subjective opinions.
- The NCUSIF one percent deposit and goodwill are deducted from capital in the calculation.
- The ten percent well capitalized rate is too high and not adequately supported by legislative or regulatory authority.
- Additional consideration should be given to what makes a credit union "complex" for purposes of the RBC rule. The proposed rule defines "complex" as simply credit unions with assets greater than $100 million.
- While interest rate risk was removed as a component of establishing the risk weights for certain asset categories, NCUA is considering adding a separate interest rate risk component to the RBC rule even though an interest risk rule already exists that credit unions must comply with. The existing rule is sufficient for monitoring interest rate risk.

- The proposed rule does not include a supplemental capital option for all credit unions that would better position credit unions to manage capital.

The following provides additional detail on the bullet points listed above.

NCUA has not demonstrated the need

Credit union capital withstood the most challenging seven-year economic turmoil that we have ever seen. Credit union capital on average is almost at the same very strong level as it was before the severe economic downturn that began in 2008 and after absorbing the corporate CU capital write-downs as well as the assessments for the Corporate Stabilization Fund (a good portion of which now appears to have been unnecessary) during the past seven years. Existing regulations that require credit unions to establish an allowance for potential loan losses, stress test their balance sheets, establish an interest rate risk policy, and understand the various risks in different aspects of the credit union operations, etc. have adequately enabled credit unions to manage risk very well. We still do not believe that NCUA has demonstrated the need for this RBC rule.

Throughout the proposal NCUA references the requirements being similar to what banks have. We are not convinced that this is necessarily a good thing. The losses incurred by banks during the economic downturn far exceeded losses incurred by credit unions, and an argument can be made that many of the credit union losses were the result of excessive risk being taken by banks and other financial service providers, not the result of undue risk taking on the part of natural person credit unions. NCUA continues to file lawsuits against various entities that infer unscrupulous and deceptive practices that led to the losses incurred in the credit union system. This approach seems to us to be a solution in search of a problem.

CUSO investment and mortgage servicing risk weights are onerous, unnecessary and result in a strategic disadvantage

As mentioned previously, the risk weights being applied to CUSO investments (150%) and mortgage servicing assets (250%) are too high and not comparable to risk weights for banks on similar assets. Adopting them could place credit unions at a strategic disadvantage relative to other financial institutions. We would recommend that NCUA reduce these risk weights to 100%.

We do not believe that NCUA has fully recognized a primary purpose of CUSOs in this proposed regulation. This is evident by the 150% risk weight applied. While this is lower than the original proposal of 250%, it still infers that there is excessive risk in all CUSO investments. A key reason many CUSOs are established is to help mitigate or share risk across multiple organizations. The benefits that credit unions see are not only based on the CUSO paying a dividend to the credit unions involved; quite often, there are significant cost savings to the credit unions that are not directly evident in an evaluation of risk assets. The assumption in the proposed rule is that all CUSOs are the same. This again is an area where we feel NCUA needs to spend time doing a more thorough analysis before promulgating a risk-based capital rule. There needs to be differentiation in types of CUSOs and the associated risk to the credit union. All CUSO investments should not be risk weighted at 150%. PSCU for example, has consistently paid a patronage dividend to the credit unions involved. This is only possible as a direct result of the economies of scale generated by the participating credit unions, reducing the overall risk to this group. A portion of this dividend is reinvested as additional capital in PSCU and increases the CUSO investment on the credit unions' financials. Under the proposed rule, this increased investment would also be risk weighted at 150%. Punishing credit unions by requiring excessive net worth based on the success of a CUSO, which ultimately reduces the risk profile of the credit union, does not make sense to us. In addition to PSCU, some of the financially strongest and most important organizations supporting the entire credit union system are CUSOs. They would be affected negatively by this unnecessarily high risk weighting.

Credit unions that have sold mortgages while maintaining the servicing rights have done so to reduce exposure to interest rate risk by selling long term fixed-rate assets. This is part of managing risk. The 250% risk weight being applied to mortgage servicing assets infers that these assets are more risky than if the credit union held the long-term mortgages in its portfolio. NCUA has expressed concern over the impact interest rate risk may have on credit unions as rates begin to rise. Penalizing a credit union for managing interest rate risk with a higher risk weight on servicing assets could result in credit unions choosing to not sell these mortgages and keep them in their portfolio, which could result in greater risk to the overall balance sheet.

Requirement of a Capital Management Plan

We are in absolute agreement with NCUA removing the individual minimum capital requirement that NCUA could have imposed on a credit union in the initial proposal. However, we believe the proposed requirement that a credit union develop a capital adequacy plan that is subject to examination and supervisory review still allows NCUA to potentially require a higher RBC ratio for a credit union based on subjective opinions of an examiner. We continue to believe that if NCUA develops a risk-based capital proposal that is well thought out and supported by valid empirical data, it will not be necessary for NUCA to require a higher RBC ratio than is required by the regulation. NCUA currently has other regulatory options available at its disposal if there are safety and soundness concerns. Today, examiners "require" higher net worth ratios, well above the 7% well capitalized ratio, based solely on the examiner's subjective opinion on the level of capital that a credit union should hold. In multiple cases, examiners have "required" through the examination report findings that credit unions should maintain leverage net worth ratios higher than 10%. There is no regulatory basis for this, only the examiner's opinion. With this approach already being used with the leverage ratio, we are very concerned with how this capital management plan review would be implemented.

Deduction of NCUSIF deposit and goodwill from capital calculation

Under the proposed rule, the NCUSIF one percent deposit is deducted from the capital calculation and also deducted from the total risk-based assets. While this appears as an equal trade-off, it does not function that way. By deducting the NCUSIF deposit from both sides of the equation, the net effect is a lowering of the risk-based capital ratio by over one percent in some instances. Since NCUA, in its September 2013 White Paper on NCUSIF Improvements, states that "Moreover, because one percent of the 1.3 percent is in the form of contributed deposits from insured credit unions and because those deposits also contribute to the net worth of the credit unions themselves,…", it does not follow that the deposit should be deducted from net worth when calculating a risk-based capital ratio. We recommend that NCUA not deduct the NCUSIF deposit from either side of the balance sheet, but leave it as an asset with a 100% risk weight.

Deduction of goodwill from both sides of the equation will have a similar effect. The definition of goodwill is the excess market value of assets compared to the book value brought over in a merger. It is a GAAP requirement. We support NCUA's proposal that goodwill from supervisory mergers continue to be included in the RBC calculation. We would further encourage NCUA to allow inclusion of goodwill from any merger that meets the same completed by dates as included for supervisory mergers.

Ten percent well capitalized rate is too high

In the proposed rule, NCUA establishes an arbitrary ten percent risk-based capital ratio to be considered well capitalized. We continue to believe that there is not sufficient legislative or regulatory basis for establishing this rate. NCUA has not provided any supporting data sufficient to indicate why this rate is proper. Banks are not subject to the same level of capital that credit unions currently are, and certainly nowhere near what credit unions would have to meet in the proposed rule. This is another example where NCUA infers that there is higher risk in credit unions than in other financial institutions. This is absolutely not true, and is borne out in the loss ratios for various financial institutions. Credit union loss ratios have historically been lower, and certainly do not support this level of capital requirement.

Definition of "complex" credit union

The Federal Credit Union Act requires a risk-based capital calculation for credit unions that are deemed "complex." The FCU Act further requires NCUA to consider "the portfolio of assets and liabilities" of credit unions when determining whether they are complex. The proposed rule defines a "complex" credit union as one having assets greater than $100 million, without any consideration to the products and services that the credit union offers. We do not agree that asset size alone makes a credit union complex. It is our position that NCUA should also identify a mix of deposit account types, lending and investment types, and *additio*nal member services as factors to be considered in defining a credit union as complex. If asset size alone is to be used, we would recommend increasing the cutoff to at least $250 million, which we believe is more likely to include credit unions that are offering a broad array of products and services that would fall under a broader definition of complex.

Adding a separate Interest Rate Risk component to RBC rule

While interest rate risk was removed in the revised proposal as a component of establishing the risk weights for certain asset categories, NCUA is considering adding a separate interest rate risk component to the RBC rule. In February 2012 NCUA issued a final rule requiring federally insured credit unions to develop and adopt a written policy on interest rate risk management and a program to effectively implement that policy, as part of their asset liability management responsibilities. At the time this rule was issued, NCUA indicated that the required policy and program would be a factor in determining a credit union's insurability. It would appear to us that this rule should be sufficient for addressing interest rate risk without the need to try to find a way to further manage it by adding a RBC component as well. Adding additional regulatory burden through this approach does not mesh with NCUA's stated goal of minimizing and reducing the regulatory burden on credit unions. We would recommend that NCUA not add any additional interest rate risk component to the RBC rule.

Supplemental Capital

We continue to believe that NCUA needs to develop a way to allow greater access to secondary capital by all credit unions. We appreciate the delayed implementation timeframe in the proposed rule, but do not believe that any final RBC rule should become effective without supplemental capital being available to all credit unions. With RBC, capital management becomes increasingly important. Building capital solely based on the ability to generate net income may force credit unions to limit services that they would otherwise offer to members because they have no efficient way to increase capital to the level that may be needed to account for RBC requirements with the new services. We understand that NCUA is reviewing how best to make supplemental capital available to all credit unions, but would want to make sure that access to this additional capital source is in place prior to the effective date of any RBC final rule.

As stated above, the ICUL supports the concept of risk-based capital. We believe that a much broader overhaul of the capital regulations should occur that replaces the existing leverage and risk-based capital ratios with one risk-based ratio that is appropriately designed to recognize both the risk and the unique cooperative structure of credit unions. The current proposal, while much improved from the original proposal, does not accomplish this and we respectfully recommend that NCUA table the proposed rule until such time that NCUA, in conjunction with the credit union community's input, can develop an acceptable risk-based capital system.

Thank you for the opportunity to comment on the proposal. If you have any questions about our letter, please do not hesitate to give me a call at (317) 594-5320.

Sincerely,

John McKenzie
President, Indiana Credit Union League