Great Lakes CREDIT UNION
OUR business is YOUR future!

April 24, 2015

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

Re: NCUA's Risk Based Capital Proposal, RIN 3133-AD77

Dear Mr. Poliquin:

On behalf of Great Lakes Credit Union, we appreciate the opportunity to submit comments to the National Credit Union Administration (NCUA) Board's request for comments on the NCUA's second proposed-risk based capital rule (RBC2). Great Lakes is located in the Chicago, Illinois market area and has 56,000 members, $650 million in assets and 11 branches.

We believe the Risk Based Capital rule is unnecessary, burdensome, and question whether it would even be effective at preventing credit union failures. It will also put credit unions at a competitive disadvantage to other financial institutions not regulated by NCUA. It is a solution that will not work to a problem that does not exist. In addition, we believe a single-tier framework such as the one contained in the current PCA requirements mandated by Congress is sufficient to provide NCUA the necessary means to regulate credit unions.

We also believe there is no evidence that a Basel-style RBC rule has ever been effective at predicting risk or preventing financial institution failures. We ask the NCUA Board take time to study the work of Mr. Thomas M Hoenig, Vice-Chairman of the Federal Deposit Insurance Corporation. Among his many comments on the subject is this, from a speech given on April, 9, 2013:

> *"Finally, we should not accept even comforting errors of logic which suggest that Basel III requirements will create stronger capital than those of Basel II, which failed. Instead, past industry performance and mounting academic and other evidence suggest that we would be best served to focus on a strong leverage ratio standard in judging a firm and the industry's financial strength. Our responsibility as regulators and deposit insurers is to choose the best available measure that will contribute to financial stability."*

It is clear that Mr. Hoenig does not view Basel-style risk estimates to be the best measure of financial stability, and history has proven him right. NCUA should not follow with Basel-style standards of its own.

2111 Waukegan Road • Bannockburn, IL 60015 • (800) 982 - 7850 • www.glcu.org

Having said that, NCUA has addressed some of the concerns credit unions raised related to the first proposal; however, we feel the following substantive changes must still be made to ensure the final rule is truly comparable to Other Banking Agency requirements and does not put credit unions at a competitive disadvantage:

1. **Eliminate the 10% Risk-Based Capital Ratio Requirement**
   Unless all credit unions have the ability to meet the 10% requirement with secondary (Tier 2) capital, as banks do, the proposed rule will create a more restrictive capital requirement that places credit unions at a competitive disadvantage to banks. NCUA should either delay the final release of the risk-based capital rule until it has developed a secondary capital rule or eliminate the 10% risk based capital ratio requirement and establish a single-tier requirement of 8% that aligns with the banking industry's Tier 1 capital requirement.

2. **Eliminate the Concentration Risk Thresholds**
   The proposed rule also places credit unions at a competitive disadvantage to banks by requiring credit unions to hold incrementally more capital than banks given similar levels of asset concentration. The historical loss data provided by NCUA in the proposed rule does not support establishing a higher capital standard for credit unions than banks, and, NCUA has not provided any evidence the proposed concentration risk thresholds align with increased capital at risk. Additionally, none of the other Banking Agencies have adopted concentration risk thresholds in their risk weights. NCUA needs to eliminate the proposed concentration risk thresholds and manage concentration risk through the examination process as it has decided to do for Interest Rate Risk.

The following are more additional specific recommendations for improvements to the proposed rule:

Risk weights and Concentration Percentages. The risk-weights and concentration percentages do not take into account any of the standard credit risk factors such as type of loan, LTV, credit score, variable versus fixed rate, or origination channel. The concentration percentages are not correlated with historical loss experience. The proposal cannot capture credit risk accurately if it does not distinguish the appropriate credit risk characteristics. The appropriate credit risk factors should be considered in the proposed risk-weights.

Mortgages, Junior Real Estate, and Commercial loans. NCUA's risk weights for mortgages, junior real estate, and commercial loans vary based on the concentration of these asset classes on the balance sheet. This structure requires credit unions to hold incrementally more capital than banks given similar levels of asset concentration. This requirement puts credit unions at a competitive disadvantage and it fails to meet the standard of comparability to the other Banking Agencies' PCA requirements.

In short, NCUA"s proposal requires credit unions to hold more capital than banks given similar levels of asset concentration. We do not believe this creates a comparable capital framework as it puts credit unions at a competitive disadvantage; particularly for mortgages and junior real estate where the capital requirements materially increase even at relatively lower levels of concentration (e.g., 35% and 20% of assets).

Additionally, the historical loss data provided by NCUA does not support establishing a higher capital standard for credit unions than banks. The loss history shows the performance of credit unions is comparable to, and in the cases of mortgages and commercial loans better than, the banks. **The historical loss data shows there is no justification to establish higher capital standards than those applied to banks**. Adhering to the standards of compatibility, we recommend NCUA eliminate the concentration risk thresholds for these asset classes and set the risk weights equal to those applied to the banking industry (e.g., 50% for mortgages and 100% for both junior real estate and commercial loans). Not only will this remove the competitive disadvantage; it will better align with broader financial institution capital requirements and historical loss experience.

Mortgage Servicing Assets. With respect to the **mortgage servicing rights**, the 250% risk weighting is excessive, especially for loans sold without recourse and it is much higher than the risk-weight for the mortgages that were sold to create the MSR's. The credit risk associated with MSR's is the same as the credit risk for the underlying mortgage. We sell many of our mortgage loans to mitigate risk on our balance sheet, but retain servicing to ensure strong member service. If the higher risk weight is due to interest rate risk, then it is not consistent with the proposal's focus on credit risk. A 250% risk-weighting would be punitive treatment of a credit union that is acting prudently both to the institution and to the membership by selling an asset and retaining servicing. **We would recommend lowering the risk-weighting to 100%.**

Investments in CUSO's. Credit unions are able to offer valuable and needed services to their membership through CUSO's that they could not otherwise offer them. CUSO's are a prime example of how credit unions collaborate and cooperate to serve their members and enhance the importance and value of the credit union cooperative system. CUSO's provide a very important and necessary source of additional non-interest income to credit unions-income that will be critical in enabling credit unions to raise and sustain the required additional levels of risk-based capital under the proposed rule. Therefore, it is not helpful to credit unions and their members for the NCUA to propose rules that unnecessarily discourage creating CUSO's or inhibit their growth and development. We support the proposed treatment of consolidated CUSO investments and loans in which no separate risk rating would apply. **We would recommend the risk weight for CUSO investments and CUSO loans be the same at the lower level of 100%.**

Goodwill and Other Intangible Assets. In the original proposal, goodwill and other intangible assets (OIA) would have been excluded from the numerator of the risk-based capital ratio. In RBC2, a subset of goodwill and OIA could be retained in the numerator of the RBC ratio until 2025. That subset would be limited to goodwill and OIA that arise from "supervisory" mergers prior to one month after publication of the final rule. Supervisory mergers would be broadly defined as assisted mergers, emergency mergers, or mergers where the NCUA or state supervisory authority selected the surviving credit union.

The retention of goodwill and OIA in the RBC numerator until 2025 is an improvement over the original proposal, but does not go nearly far enough. We believe a strong case can be made for the inclusion for all goodwill and OIA in the numerator so long as these intangible assets meet GAAP requirements, i.e., are subjected to annual goodwill impairment testing. The exclusion of non-supervisory goodwill from the numerator will discourage some well managed and well-capitalized credit unions from participating in mergers, and many mergers serve to benefit the members of both the surviving and nonsurviving credit union. Similarly, mergers can also have a favorable influence on safety and soundness—producing institutions that in combination have stronger financials and are able to weather extreme economic swings.

At a minimum going forward non-supervisory goodwill that meets annual impairment testing should be retained in the numerator over a ten-year phase out period. In other words, after any future merger, the amount of any resulting goodwill or OIA that could be included in the numerator of the RBC ratio would be reduced by one tenth each year for ten years. Regardless of whether or not non-supervisory goodwill is permitted in the numerator, we strongly believe that all previous goodwill should be grandfathered without time limit, subject to impairment testing.

NCUSIF deposit. As pointed out in our response to the initial proposal, the NCUA needs to reconsider the deduction of the NCUSIF deposit from equity (and from assets denominator). The proposal indicates many times that these RBC standards are necessary to reduce the risk to the NCUSIF; and such as, eliminating this NCUSIF deposit is contradictory to how the credit union industry attempts to manage the risks. This proposal also implies that the deposit is worthless and should be expensed versus the current method of capitalizing the deposit.

Publically Traded Equity Investments. We do not support the 300% risk-weight for publically traded equity investments (non-CUSO) which is excessive and will prevent credit unions from engaging in employee benefit funding. All credit unions are to account for investments in accordance with GAAP. That method of accounting requires the investment to be recorded at market value and the description of "publicly traded" indicates that market value is easily determined. **That makes the weighting at 300% highly excessive. It needs to be revisited and significantly lowered**, especially with the amount of class B Visa shares that are held by a significant number of credit unions and also the employee benefit funding allowed by NCUA Regulation 701.19. Similar consideration

should be made for the separately traded life insurance contracts. The employee benefit program would allow a credit union to set up an investment fund to cover the cost or fund the anticipated increase in employee benefits such as health insurance. With health care costs rising steadily each year, many credit unions are looking for ways to help cover these costs so they can continue offering competitive employee health insurance benefits as well as other benefits. Placing such a high risk-weight on equity investments would likely dissuade credit unions from either continuing or starting these types of plans that can help cover some of their benefit costs. Long term, this could impact credit unions' ability to offer competitive employer funded health insurance benefits. In turn, that could make it hard to attract and retain high caliber employees.

MPF Program. We are also concerned about the definition of the **Mortgage Partnership Finance (MPF) Program**. As proposed, the definition could be construed as limiting the benefits of the risk based capital treatment only to those credit unions that service their MPF loans, but not those that choose to sell the loans servicing-released. Whether or not credit unions service their mortgage loans does not alter their credit enhancement obligation in any way. We urge NCUA to remove the words. "and servicing them" from the definition of MPF Program. We also recommend adding language to clarify that the definition of the MPF program does not apply to the Mortgage Purchase Program (MPP), a secondary market alternative offered by certain Federal Home Loan Banks that achieves credit enhancement by creating a contingent asset for the credit union participant, in contrast to the contingent liability obligation created under the MPF Program. Since the purpose for the risk based capital requirements for off-balance sheet activities is to ensure credit unions hold capital against recourse risk, and MPP loans do not have such risk, MPP loans should fall outside of the definition of the MPF Program.

Interest Rate Risk Reg. Proposal (IRR). Regarding the NCUA's indication of its intention to promulgate a new IRR rule, **we would recommend using a supervisory, rather than regulatory approach**, examining the risk exposure based on a holistic depiction, including all assets, liabilities, and off-balance sheet positions.

We are aware and concerned with the divergent opinions regarding this proposed regulation, including the various opinions as to the legality of the NCUA's authority to issue such a rule. Congress has not expressly authorized the Board to adopt a two-tier risk-based net worth standard. NCUA Board Member J. Mark McWatters, the dissenting vote on the proposal, called NCUA's lack of legal authority the most "fundamental issue presented before the Board". We believe this issue should have been resolved prior to the issuance of any rule.

While we are encouraged by the NCUA's willingness to make a number of changes in the revised proposal, we are not convinced of the legality or necessity of this new rule. And there is one very important question that should be asked, "Do the benefits from this new regulation outweigh the costs to our industry?" Our opinion is that they do not. We believe that this is an overly complex, costly and unnecessary regulation and we urge the NCUA to reconsider the implementation, as proposed.

Thank you for your continued commitment to listen to the feedback from credit unions on this important issue.

Sincerely,

Vikki Kaiser

Vikki Kaiser
President/CEO