Holyoke
CREDIT UNION

April 24, 2015

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

Via email: regcomments@ncua.gov

RE: Comments on Proposed Rule: Risk-Based Capital

Dear Mr. Poliquin:

On behalf of Holyoke Credit Union (HCU), we appreciate the opportunity to submit comments on the National Credit Union Administration's (NCUA) proposed rule: Prompt Corrective Action – Risk-Based Capital (RBC2). By way of background, HCU is a federally insured, Massachusetts state-chartered credit union. As of March 31, 2015, HCU had total assets of $150.1 million and served 17,196 members from 3 branch locations. Moreover, in regard to this comment letter, it is important to note that as of the above date HCU has retained servicing on over $187.8 million of first mortgage loans made to our members and sold into the secondary mortgage market through the federal housing finance agencies (the GSEs).

To begin, HCU applauds the NCUA for reviewing its initial proposal and subsequently improving upon it. However, we believe RBC2 still contains major shortcomings. This letter will address RBC2's very unfavorable capital treatment of mortgage servicing assets (MSAs).

Credit unions exist to meet their members' financial needs. Housing is a primary need of every member. Therefore, if credit unions are to remain a vital and significant financial services provider they must meet their members' need for housing finance. The NCUA's adoption of the punitive capital treatment of mortgage servicing assets under Basel III is a major threat to the credit union business model. Credit unions did not cause the recent financial crisis, and we should not bear the weight of new MSA regulation. The Basel III MSA regulation may be very appropriate for the big banks (Ally, Bank of America, Citi, JP Morgan, Wells Fargo), but this capital treatment is seriously flawed and overreaching in regard to credit unions.

Mortgage lending is key to relationship building and helps HCU to remain competitive. However, in order to execute on this strategy we must service the loans we make, whether those loans are held in the HCU portfolio or sold to Fannie Mae, Freddie Mac, the Federal Home Loan Bank (the GSEs) or Ginnie Mae.

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Members insist upon local servicing. We've learned that members are deeply concerned about servicing; they want to know their servicer. They value and seek out local servicing. The member wants the ability to reach out and interact with their servicer; the people they chose to originate their mortgage loan. This is only possible when servicing is done on the local level, by a credit union.

Local servicing is key to the marketing of HCU's mortgage originations, and taken together, origination and servicing are integral to our relationship-banking business model.

Why do we sell the mortgage loan and yet retain the servicing? Because selling mortgage loans while retaining the servicing allows HCU to manage and control interest rate risk, access a reliable source of funding that precisely correlates with the demand for loans, and further, allows HCU to foster a close relationship with members upon which we can build other product and service relationships.

Cost-effective servicing is necessary in order for HCU and the credit union industry to remain competitive in the mortgage origination business. In general, credit union mortgage loan servicing improves overall loan performance. Credit unions, by their nature, will intervene early to help keep a mortgage out of default; often at the first signs of distress.

Credit unions have a proven record of sound underwriting, focused on the ability to repay. By and large, credit union mortgage product offerings are plain-vanilla, fixed rate loans with 30 and 15-year terms, designed to provide the borrower with payment certainty. Credit unions did not underwrite exotic products such as option-arms. This combination of quality loan products, soundly underwritten and prudently serviced is the historical record of the credit union industry.

The Basel III treatment of the MSA is a big bank solution to a big bank problem. The Basel III solution is not appropriate for the credit union industry. Such a rule, with such a broad adverse impact, should be clearly supported by data and analysis from the credit union industry. To simply follow the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve, and Office of the Comptroller of the Currency (Other Banking Agencies) big bank fix is a disservice to credit unions and to the communities that credit unions serve.

The NCUA, as justification for its proposed large increase in credit union capital required to support MSAs, noted that these assets are complex and volatile. NCUA also stated MSAs are sensitive to the costs associated with servicing, and further noted that there is no differentiation between the risk as it relates to MSAs for credit unions versus banks, and therefore, the NCUA Board believes adopting the Basel III capital treatment would generally maintain comparability with the Other Banking Agencies' capital regulations.

However, the NCUA's reasoning is flawed because there are a number of profound and dramatic differences between an MSA at a credit union and an MSA at a big bank.

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In regard to MSA complexity and volatility, the NCUA noted that MSAs typically lose value when interest rates fall and borrowers refinance or prepay their mortgage loans; thus concluding that MSA valuations are highly sensitive to unexpected shifts in interest rates and prepayment speeds.

However, unlike the big banks, credit unions typically take a more conservative approach to the initial value placed upon the MSA. As an example, a credit union may value the servicing asset for a 30-year fixed rate loan with a multiple of four (4) times the servicing strip of 25 basis points; whereas, a big bank for the same loan may use a multiple as high as eight (8). Moreover, almost all credit unions can be expected to account for the MSA with the Lower-of-Cost-or-Market (LOCM) option; whereas the big banks will employ the Fair Value option. The Fair Value option provides the big bank with the potential to recognize gains in MSA market value in other non-interest income. By a deliberate decision a big bank has created a volatile asset. However, credit unions through the choice of the LOCM accounting option establish a method that has the effect of limiting the MSA's inherent volatility.

Further, this choice of accounting approach highlights a fundamental difference between big banks and the credit union industry. The big banks engage in servicing as a separate and distinct line of business, often through affiliates or subsidiaries. The big banks establish profitability and other performance metrics and actively engage in the wholesale buying and selling of mortgage servicing rights.

In contrast, credit unions service mortgage loans made to their members. The loans are sold as a primary method to manage interest rate risk and to enhance liquidity. Loan servicing is vital to maintaining the member relationship and, as such, selling the loan with the servicing released is not considered to be a viable strategic option.

It is certainly true that MSAs become impaired when interest rates fall and borrowers refinance or prepay their mortgages. The single biggest risk in the ownership of residential MSAs is the risk of prepayment. However, credit unions have a natural or macro hedge to offset prepayment risk. In a period of falling rates, and assuming the credit union is still in the mortgage business, they can expect to see mortgage production volumes up and origination margins up. These increases are almost always high enough to more than offset the loss in MSA value.

Further, there are many other assets on a typical credit union's balance sheet that have prepayment risk in addition to credit and liquidity risk. The issues of complexity and volatility, in regard to credit union MSAs, do not warrant a 250% risk-weight.

The NCUA further notes that MSAs are also sensitive to the costs associated with servicing; thus implying that servicing costs are extremely variable. However, once more, this statement is only correct in regard to the big bank experience.

The big banks, in large part due to their for-profit MSA business model, never developed an adequate servicing infrastructure. Their egregious failures to properly interact with borrowers' and to service the loans entrusted to their care, ultimately resulted in the National

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Mortgage Settlement and soon thereafter, the promulgation of national servicing standards by the Consumer Federal Protection Bureau (CFPB).

However, servicing costs at credit unions are largely fixed and will increase only in proportion to increases in the servicing portfolio. This is due to the fact that almost all mortgage loans sold by credit unions are sold to Fannie Mae, Freddie Mac, a Federal Home Loan Bank, (the GSEs) or Ginnie Mae. The GSEs and Ginnie Mae have played a leading role in helping credit unions to standardize servicing processes and in establishing minimum servicing requirements, default processes, and loan modification programs through their respective seller/servicer guides. Notwithstanding the fact that credit unions found the mortgage crisis to be difficult and challenging, the additional burden of mortgage loan default management and loss mitigation did not impact costs to a significant degree. Credit unions, by virtue of their member service approach and their contractual agreements with the GSEs and Ginnie Mae, had well-established servicing and loss mitigation infrastructures in place. In contrast to the big banks, servicing costs in the credit union industry are relatively stable.

The mortgage servicing asset in the credit union industry is not comparable to the mortgage servicing asset in the banking industry. I encourage the NCUA to reexamine the MSA and to recognize the fundamental differences between the management of this asset in the credit union industry, the NCUA's industry, and the management of this asset in the banking industry. In particular, please acknowledge that the Basel III capital treatment of the MSA was in reaction to big bank failures to properly service mortgage loans. The NCUA capital regime in regard to the MSA should not be comparable to the regulatory risk-based capital measures employed by the Other Banking Agencies. The NCUA has offered no data or empirical evidence, whatsoever, to support the conclusion that MSAs are a high-risk asset other than referencing the blatant failures of the big banks.

The proposed 250% risk weighting on the mortgage servicing asset would be punitive and unnecessary. The risk weighting should be reduced to 100%. By this action NCUA will have tailored the MSA capital treatment to the unique nature of the credit union industry. This treatment will support those credit unions that sell mortgage loans to manage interest rate risk. A 100% MSA risk weight is the best public policy as it is fair to all concerned parties: credit union members and future members, the credit union industry, and the regulator.

Thank you again for the opportunity to comment on the proposed rule. We would welcome the opportunity to discuss our concerns with you or to respond to any questions you may have on our comments contained in this letter.

Sincerely,

Michael E. Murphy
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