AMPLIFY®
CREDIT UNION

April 24, 2015

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

RE: COMMENTS ON PROPOSED RULE: RISK-BASED CAPITAL – RIN 3133-AD77

Dear Mr. Poliquin:

I am writing to comment on the revised risk-based capital regulation proposal (RBC2) approved by the National Credit Union Administration (NCUA) Board on January 15, 2015. I write on behalf of Amplify Federal Credit Union (AFCU), which is based in Austin, Texas and serves over 50,000 members. AFCU is "well-capitalized" under current risk-based net worth (RBNW) requirements as well as under the original risk-based capital proposal (RBC1) and RBC2. We write as this issue certainly deserves the careful consideration of all stakeholders in the process due to the long-term impact of the proposed regulation on the industry.

Thank you for listening to the more than 2,000 comment letters received on the first proposal (RBC1), making significant improvements in this new proposed regulation and providing a second comment period. I appreciate the opportunity to comment and look forward to continued meaningful dialogue with the agency on this proposal.

POSITION

Our position is that credit unions already have a risk-based capital measurement system under current NCUA risk-based net worth requirements (RBNW) regulations that have served the movement well. Credit unions successfully weathered the storm of the great recession under our current, one-tier system and emerged stronger than ever without any taxpayer assistance. We do not believe there is a compelling need for the two-tiered risk-based capital requirements as proposed. Under the current regulation, the credit union industry already has higher capital standards. We already have extra risk-based capital over that of other financial institution regulations with a required 7% leverage ratio to be well capitalized. The unique nature of credit unions is evident in lower loss ratios over time in comparison to other financial institutions. Credit unions have demonstrated greater real-world success in managing through tough economic times. When considering capital requirements, this must be factored in as part of the equation. The current RBNW regulation does consider parity with other financial institution regulations and captures the unique nature of credit unions, as mandated by Congress. In fact, our system should be promoted by NCUA as the standard for other financial institution regulators. Plain and simple, our system works.

Based on the above, we encourage NCUA to withdraw the proposal altogether. However, we offer the comments below as suggestions to improve the proposal should you move forward.

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COMMENTS FOR RBC2 IMPROVEMENT

While we are pleased with the positive changes made from RBC1 to RBC2, there still remains several issues of concern about RBC2 discussed below that we respectfully request the NCUA consider in further risk-based capital (RBC) policy formulation.

- **COMPLEX CREDIT UNIONS** - Defining complexity as credit unions of over $100 million is an improvement over $50 million as proposed by RBC1. However, defining complexity by asset size remains a simplistic approach. Complexity is best determined based on the asset and liability composition of the credit union's balance sheet as stated in the Federal Credit Union Act (FCUA).

- **INTEREST RATE RISK (IRR)** – Thank you for removing interest rate risk weightings from RBC2. IRR is best managed by NCUA through the exam and supervision process and should not be embedded in any risk-based capital regulation. AFCU has prudent asset-liability management (ALM) policies and procedures and models balance sheet performance under different interest rate scenarios on a regular basis. This, more in-depth analysis, is reviewed by NCUA in the exam process. Based on this, we further suggest that there is no need for an additional, separate IRR regulation. The current NCUA guideline, last revised in 2012, provides good ALM guidance and serves the industry well as is.

- **SUPPLEMENTAL CAPITAL** – Supplemental capital should be included as capital in any risk-based capital proposal. Although legislation is necessary to allow supplemental capital for all credit unions, it can be included for purposes of risk-based capital in the RBC2 proposal.

  We, then, strongly urge NCUA to ask Congress to allow supplemental capital for all credit unions. We support the availability of supplemental capital for several primary reasons. First, additional capital will provide an extra layer of safety and soundness to credit unions, strengthen their balance sheets, which will in turn will provide better protection to the NCUSIF and industry overall. Second, if credit unions are going to be held to higher standards of capital requirements, then it logically follows that they ought to have maximum availability of all capital sources to maintain such higher RBC standards. Finally, additional capital will enable well-run credit unions to issue such capital at an attractive cost and to grow faster than their internal Return on Equity growth rates allow. This will enable them to export their successful business model to more members, thereby helping more people with their financial needs. This is consistent with our goal as a credit union to help members. In fact, we cannot really think of a significant negative or downside to the concept of supplemental capital. So we encourage the NCUA to provide supplemental capital availability to all credit unions.

- **CAPITAL ADEQUACY REQUIREMENTS** - RBC2 requires credit unions to hold capital commensurate with risks, notwithstanding the RBC2 and PCA net worth requirements. So while RBC2 improved over RBC1 by eliminating unilateral examiner authority to determine capital, the situation remains that a credit union could be reclassified and held to higher capital adequacy standards based on its strategic plan and/or long-term capital ratio metrics. The fear here is that the NCUA will substitute its own judgment for that of management and the board. We do not believe that strategic plans should be subject to arbitrary NCUA standards or targets, that such micro-management is regulatory over-reach and could have a chilling effect on management discretion, innovation, and risk management.

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- **GOODWILL TREATMENT** – The proposed goodwill treatment in RBC2 is an improvement over RBC1. Supervisory goodwill is now included in capital but only until 2025. Thereafter, it is excluded and will thus have a detrimental impact on the RBC measurement. However, NCUA should consider the wisdom of that approach, especially in a consolidating industry. Goodwill should be included. Excluding goodwill from RBC is a disincentive to mergers, and may allow weak credit unions to continue operating, which will ultimately cost more to the NCUSIF and the industry for those that fail. Successful credit unions will not want to take on struggling credit unions due to the inherent goodwill risk penalty they will accrue from the acquisition. This future unintended consequence should be strongly considered by the NCUA in goodwill treatment. Failure to address this weighting issue will cause more, not fewer, credit union failures at a greater cost to the industry.

- **NCUSIF DEPOSIT** - Our deposit in the National Credit Union Share Insurance Fund (NCUSIF) should not be deducted from the denominator (or numerator) for risk-based capital. This makes no logical sense. This approach has a disproportionately negative impact on a credit union's RBC ratio as proposed. We strongly disagree with this deduction for the following reasons: 1) the NCUSIF deposit is not a component of capital on the balance sheet, but is an asset that should be risk-weighted accordingly in the denominator of the risk-based calculation, 2) the deposit is not a risk asset as it is backed by the full faith and credit of the US government; and 3) the deposit has been on our balance sheet since inception of the NCUSIF and has weathered many economic downturns, including the most recent "great recession."

- **INVESTMENT RISK WEIGHTS** - The NCUA made several positive changes in this area over RBC1, and we sincerely appreciate that. Removing the IRR component (i.e. WAL) and basing risk weights on the credit risk of the underlying investment was a welcome change. Thank you for listening before, and we hope that you will consider our additional comments on proposed RBC2 risk weightings:

    - <u>Subordinated Tranche of any Investment</u> - a 1250% risk weight for credit unions is high. We disagree with this risk weight. It is unsubstantiated with empirical evidence of need and has no comparison to bank regulation. Without better definition, these investments should follow the same criteria as the underlying MBS investment of 50% as outlined in the proposal. We do appreciate the option to utilize the gross up approach for parity with bank regulation.

      In fairness, perhaps NCUA should first better define the meaning of a "subordinated tranche". In most MBS structures, tranches are subordinate to the tranche above them, but perhaps NCUA is referring to certain strips that, by their definition, might require such a high risk weight.

- **LOAN RISK WEIGHTS** – The NCUA made several positive changes in this area over RBC1, and we sincerely appreciate that. Thank you for listening before, and we hope that you will consider our additional comments on proposed RBC2 risk weightings:

    - <u>Real Estate Loans</u> – First lien loans > 35% of assets still have a higher risk weight of 75% vs 50% for banks. The empirical data for credit unions indicates a lower loss ratio than banks. Taking this "unique nature of credit unions" into consideration, these risk weights should be equal to banks (50%) or lower.

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- Real Estate Loans – Junior lien loans > 20% of assets still have a higher risk weight of 150% vs 100% for banks. The empirical data for credit unions indicates a lower loss ratio than banks. Taking this "unique nature of credit unions" into consideration, these risk weights should be equal to banks (100%) or lower.

- Commercial Loans – Commercial loans > 50% of assets have a higher risk weight of 150% vs 100% for banks. While this issue does not impact us currently due to business lending caps, it seems that credit union regulations should be appropriately aligned with bank regulations. It should be noted that bank regulators only utilize the 150% risk weight for High Volatility Commercial Real Estate Loans (HVCRE) designated loans. Therefore, we suggest a 100% risk weight for this category.

- **CUSO INVESTMENTS** – Unconsolidated CUSO investments should not be risk weighted at 150%. We have seen no empirical evidence that supports such a high risk weight. CUSO investments are strategic and marked to market. Higher risk weights also have the unintended consequence of stifling innovation and collaboration in our industry. This is one of the seven credit union cooperative principles, and credits unions cooperate through CUSOs to better serve their members. Therefore, the risk should be equal to the balance on the books at 100%.

- **MORTGAGE SERVICING RIGHTS** - Mortgage servicing rights (MSR) being risk weighted at 250% makes these assets one the "riskiest" assets on the balance sheet according to the proposed regulation. Again, we have seen no empirical evidence to support this risk weighting. In our opinion, these assets should be risk-rated based on the corresponding underlying first mortgage asset at 50% as we suggested under "Loan Risk Weights" above.

  Also, consider that the accounting method for MSR's (fair value and amortization) should not be treated with the same risk weighting. Amortization is a much more conservative accounting approach, and therefore should merit the lower risk weight as suggested, not a 250% risk weight.

  Further, the NCUA should take into account the fact that Mortgage Servicing Rights provide credit unions with a built-in, natural hedge against interest rate risk. If rates go up, prepayments slow, and MSR assets increase in value, contrary to other asset values on the balance sheet. If rates go down, prepayments go up, MSR assets decrease in value, while other assets increase in value. This creates a natural, desirable hedge.

We sincerely appreciate your time in reading and considering the above commentary. We know that you have to cull through many such letters, which is a tedious process. Thank you for providing a second comment period and for seeking input from the industry in crafting regulation.

In summary, we respectfully urge NCUA to withdraw RBC2 in its' entirety and rely on the current RBNW regulation that has served the industry well and meets the mandates of Congress. However, if NCUA moves forward with RBC2, we then ask you to consider our suggestions for improvement of the proposed regulation and make the necessary revisions.

Sincerely,

Paul Trylko, President/CEO
Amplify Federal Credit Union

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