April 27, 2015

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

RE: Risk-Based Capital Proposed Rule
RIN 3133-AD77

Dear Mr. Poliquin,

On behalf of Digital Federal Credit Union, I am writing to you regarding the NCUA risk-based capital proposal. I appreciate the opportunity to provide my thoughts and concerns with the proposal as written. My primary concerns revolve around the need for such regulation, real estate loans, mortgage servicing assets, and the treatment of mutual funds. I have outlined my concerns and alternatives in detail below and I appreciate the consideration as you move forward in the rule making process.

**<u>Unnecessary Regulation</u>**

There is no clear basis for disregarding the current prompt corrective action (PCA) regulations and adopting a completely different model. There were no issues identified as part of the NCUA's most recent review of the regulation performed as part of the NCUA's rolling three-year review of regulations in 2012. This analysis was performed subsequent to the NCUA's December 19, 2011 response, included in the January 4, 2012 United States Government Accountability Office (GAO) Report to Congress (GAO-12-247)[1]. This response by Chairman Matz, indicated:

> It is also worthy to note that consumer credit unions performed very well during the worst financial crisis since the Great Depression, and NCUA was highly successful overall in mitigating failures and losses for consumer credit unions. The 85 consumer credit union failures occurred over a two and a half year period during the height of the economic crisis. As noted in the report, the level of annualized failures is relatively low, only marginally higher than pre-crisis levels, and involved institutions with less than 1% of total credit union assets. NCUA was effective in prioritizing our supervisory resources during the economic crisis to prevent the failure of larger credit unions that came under stress, and in mitigating losses for those that did

[1] http://www.gao.gov/assets/590/587409.pdf United States Government Accountability Office – Report GAO-12-247 – January 2012

In late January 2013, the NCUA's Office of General Counsel released the list of regulations being reviewed, indicating "Regulations under review in 2013 include rules governing member business loans, fair credit reporting, privacy of consumer financial information, appraisals and share insurance. ….. Additionally, NCUA will expand its review of federal credit union bylaws, which began in 2012." Based on this release, it would appear the PCA review was completed in 2012, since it was not expanded into 2013.

The NCUA suggests that the Proposed Rule was written to be more consistent with Other Federal Banking Regulatory Agencies (Other Agencies). The overall credit union industry has consistently been devoted to servicing their members differently than banks. Credit unions have proven to be an economic force in local markets and softened the effects of the recent economic downturns to its members. The overall credit union industry is not looking to be more consistent with banks and has devoted time to being a cooperative in nature.

**Real Estate Loans**

The Proposed Rule risk-weights the entire real estate portfolio with consideration of concentration risk of the portfolio to total assets of the credit union. The Proposed Rule does not consider the types of real estate loans within a credit union's portfolio. For example, a credit union's real estate portfolio's adjustable rate loans and/or shorter term loans, such as 10-year fixed rate loans, have far less risks than the portfolios' 30-year fixed rate loans. The Call Report currently has information disclosed at some level of detail for a credit union's real estate portfolio. Therefore, the NCUA should further segment a credit union's real estate portfolio to then risk-weight the varying risks within a credit union's real estate portfolio.

**Mortgage Servicing Assets (MSA)**

The revised Proposed Rule did not change MSA's risk weight of 250%. The NCUA should decrease the risk-weight of such an asset as such a high weight does not accurately reflect the risk to capital of a credit union. Additionally, the NCUA should consider the two alternative methods of carrying MSA under generally accepted accounting principles. A credit union is allowed to account for MSA at fair value or at the lower of cost or market. Using either methodology, the maximum value would be reflected as the market value. In either situation, any reduction in market value or impairment would be reflected as an earnings adjustment, to reflect any deterioration in value.

**Treatment of Mutual Fund Investments**

The "full look-through" approach described in the Proposed Rule fails to apply risk-weights to mutual fund investments in a consistent manner to the holding of the same securities by credit unions directly. For instance, a credit union that holds "U.S. Treasuries and Government Securities" would assign a risk-weight of 0% to such holdings. In contrast, an investment fund, with similar U.S. Treasuries and Government Securities, would have a risk- weight of 20%

assigned to this asset. This disparity in the treatment of the same asset when held by two different entities unnecessarily discriminates against a credit union's investments in mutual funds by penalizing the credit union for making the same investment indirectly that they could otherwise make directly. Further, the added layer of risk that the Proposed Rule assumes will be present for indirect investments is not a factor with mutual funds. Mutual funds provide daily redemption at net asset value and generally provide sold share proceeds to the investor on the next business day.

The NCUA should revise the RBC regulation so that mutual fund risk-weights are consistent with the risk-weights on the underlying instruments. We suggest a full look-through approach that is attuned to the distinctions between underlying assets that would allow low-risk mutual funds to carry risk ratios ranging between the 0% and 20% based upon the actual risk ratio of their holdings.

We also suggest that the Proposed Rule be clarified to indicate the timing of "the most recently available holdings reports" that are to be used by credit unions employing the full look-through approach for their analysis of investment fund assets.

Thank you for the opportunity to comment on this proposed regulation. The issues outlined above will have significant impact on all credit unions and will ultimately impact our ability to serve our members. I respectfully urge the NCUA to address the recommendations outlined above regarding the proposal.

Sincerely,

Caleb J. Cook

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