From:	Chris Howard
To:	_Regulatory Comments
Subject:	Comment on the Second Proposed Rule on Risk-Based Capital
Date:	Monday, April 27, 2015 4:46:05 PM

Dear Mr. Poliquin,

This is one in a series of 12 substantive blog posts addressing the second Risk-Based Capital proposal and published on CreditUnions.com over the past four weeks:

A frequent justification for accepting RBC2 without comment or opposition is that risk-weighting assets is nothing new and RBC is just the codification of good practice. Most credit unions already assess their capital adequacy using risk-based or Basel standards, so using the same approach at the systemic level seems logical. Common sense.

As a recovering banker, I'm sympathetic to this perspective. Some loans indeed are inherently riskier than others. Ensuring sufficient capacity to cover losses "is just good banking." It would follow, therefore, that RBC "is just good regulation." The problem with this analysis: It's wrong.

What works at an institutional level does not automatically scale up. Credit unions assess capital adequacy using factors that impact them locally, but those vary and they change rapidly. Individual credit unions can deal with the complexity that creates; systemic rules cannot.

Credit risk is a function of underwriting, the economy, loan portfolio diversity, institutional structure, business strategy, profitability demands, time horizons, performance-monitoring capacity, funding stability, and myriad other factors.

Systemic risk-weighting rules ignore all of these in favor of a one-size-fits-all divination of risk. Apart from everything else, this punishes credit unions that work with each member-owner to manage risk actively and rewards those who just tick boxes and do what the regulator says.

Good lenders don't manage credit risk by tweaking capital reserves. They work with borrowers as challenges arise. As a last line of defense, good lenders set aside loan loss reserves based on the actual performance of their loan portfolio and their judgment as experienced professionals. RBC2 would turn capital into one big loan loss reserve, reflecting not the unique fundamentals of each loan at each institution, but the blanket judgment of Washington bureaucrats.

No matter how intricate they may appear on paper, systemic rules like RBC are invariably and necessarily simplistic and inflexible. By reducing credit risk to a loan-type classification, RBC makes it one-dimensional. By reducing risk management of those loans to capital reserves, it distorts even that singular perspective.

Bottom line: Credit risk management is a complex and nuanced thing. RBC2 is as nuanced as a sledgehammer.

Chris Howard
Vice President of Research, Callahan & Associates
choward@callahan.com | (202) 223-3920 ext. 253
(703) 953-9730 (cell) | (800) 878-4712 (fax)

CUFSLP
CALLAHAN CREDIT UNION FINANCIAL SERVICES LIMITED PARTNERSHIP