From:	Chris Howard
To:	_Regulatory Comments
Subject:	Comment on the Second Proposed Rule on Risk-Based Capital
Date:	Monday, April 27, 2015 4:46:32 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:

An inconvenient truth for advocates of risk-based capital: Credit union reserves are not capital.

True capital is equity that can be bought, sold, or traded. Reserves cannot. They work just fine as a basis for the safe, sound operation of a financial cooperative, but they are fundamentally incompatible with a capital ratio-based trigger-response like the Prompt Corrective Action (PCA) rule RBC2 seeks to modify.

Banks needing to improve capital ratios have three choices: (1) sell equity shares, (2) issue subordinated debt, or (3) shrink the balance sheet. For most credit unions, the only option is #3.

Shrinking a balance sheet is a "scorched earth" strategy, hurting today and for years into the future. Selling assets into a down market turns paper losses into real ones, hurting owners. Reducing available credit punishes good customers. For credit unions, those two groups are the same and member-owners bear all the pain either way. Worse, reducing assets automatically cuts future revenue — the only source credit unions have for rebuilding reserves. This hurts member-owners even more.

Traditionally, credit unions managed their reserves on a flow basis, retaining earnings as needed to stay within regulations. PCA changed this. It was the political price of the Credit Union Membership Access Act, needed to correct an ill-advised U.S. Supreme Court decision (a rant for another day). It seemed reasonable: If a financial institution has too many bad assets, "prompt corrective action" is a good thing regardless of the details. Then came 2008 and the collapse of orderly markets.

The need to "mark to market" created deep "losses" on assets that were "money good" and unimpaired. Those phantom losses reduced capital ratios, forcing action. Without access to real capital, many credit unions shrank their balance sheets, harming the interests of their member-owners just to comply with a misfit regulation.

RBC2 reflects a fundamental misunderstanding of the way capital actually works in credit unions. Any change to the underlying PCA rule that doesn't address this problem demands loud, relentless opposition from every corner of the credit union movement.

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