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:

The NCUA says it needs RBC2 in order to do its job and keep credit union assets safe, but will RBC2 actually meet this objective? Here are three claims about how RBC2 will protect cooperative assets. Simple examination of the logic yields some surprising — or perhaps, not so surprising — conclusions.

Claim: The risk-based capital ratio will be a "tripwire," providing early warning of possible problems.

Ratios are lagging indicators, reflecting risk that already exists. Using a lagging indicator as an "early warning" is like putting a real tripwire at your bedroom door instead of your front door. It will alert you, but only to a threat already inside your house instead of one trying to get in.

Claim: Risk-based capital is better because it's "forward-looking"; a net worth ratio can only show trouble by declining, after the trouble has taken its toll.

If credit unions were run like banks, this might make sense, but since many credit unions — from the largest to the smallest — hold more reserves than required, this "forward view" will be cloudy at best. High ratios will be as likely to indicate a safe balance sheet as a risky one.

For discussion's sake, though, let us take these two assertions at face value and assume that RBC will work as claimed. What then? If examiners heed the warning, they will look at call reports and review risky assets — exactly the things they are supposed to be doing anyway. If examiners are doing their job, we don't need RBC2 (though they could use its guidelines as tools).

Claim: Risk-based capital will be a bulwark for the insurance fund.

This is the most disturbing claim of all. Balance sheet risk is not the primary threat to the NCUSIF, fraud and incompetence are. You can mandate good lending and risk management practices, and you can enforce rules through good examiners, but you cannot regulate against dishonesty, stupidity, or dumb luck. The only protection against these is first-rate examination.

This means that good examination is the only real bulwark for the NCUSIF. Insurance exists for when examiners fail, as even the best will on occasion. Rules like RBC2, which cannot help but distract examiners from their paramount job, can't really protect against much of anything.

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