From: Chris Howard
To: _Regulatory Comments
Subject: Comment on the Second Proposed Rule on Risk-Based Capital
Date: Monday, April 27, 2015 4:46:34 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:

When enacting complex, prescriptive regulation like RBC2, regulators must be extremely careful. Things in the real world change very quickly — witness what happened to mortgage-backed securities in 2007-8 — but regulation changes only slowly and reactively.

Credit unions need a strong financial base for safe, sound operations, but the RBC approach embodies the conceit that regulators — having lost the last war — now have full knowledge of the next one.

When people don't know what the future will bring, they take prudent, reasonable, cost-effective precautions, distributing risk, diversifying income, covering their bets, and committing themselves to active monitoring and management.

When people *think* they know the future, they behave differently. They take chances, secure in what they think they know. This can produce much bigger wins, but by leaving significant exposure to the vagaries of the future, it can also produce much bigger losses.

When a *regulator* thinks *it* knows the future, it acts consistent with its beliefs. It creates an "ideal" profile and encourages all institutions to adopt it uniformly. This is what we see the NCUA doing today. The goal may be to reduce systemic risk by limiting exposure to negative events, but the reality is different.

By punishing diversity and encouraging credit unions to become homogenous, this approach actually increases systemic risk, exposing every element of the system equally.

I learned this lesson young, watching tens of thousands of trees die in my hometown. Like cities across the country, mine adopted the American Elm as the perfect municipal tree – large, handsome, fast-growing, and hearty. When Dutch Elm Disease swept the country, tens of millions of them died, leaving tens of thousands of barren parks and playgrounds.

Concentration risk is no different in the financial world. If regulation drives every balance sheet toward convergence, then even if each institution is nominally diversified, the system will have concentration risk that has essentially been imposed upon it by its regulator.

There is an additional issue as well. One of the many ways that credit unions differ from banks is their mission to serve highly differentiated memberships with very different needs. In other words, credit unions were designed to specialize, intended to have balance sheets that might look atypical or risky. If NCUA penalizes cooperatives for this — for doing their job — that puts the entire credit union movement at risk.

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