CAP COM
Federal Credit Union
Our service says it all!℠

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April 27, 2015

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

Filed Via: regcomment@ncua.gov

Re: Proposed Rule: Risk Based Capital (RBC) 2

Dear Mr. Poliquin,

On behalf of Capital Communications Federal Credit Union (CAP COM), I would like to thank the National Credit Union Administration (NCUA) for providing CAP COM the opportunity to comment again on the above referenced rule for risk-based capital.

Cap Com is headquartered in Albany, New York with assets of $1.17 Billion as of March 31, 2015 serving 116,000 members. We are considered well-capitalized by current standards established by the NCUA with a net worth ratio of 11.15% and would continue to be considered well-capitalized under the proposed regulations.

In theory, we continue to agree that financial institutions should maintain an appropriate level of capital that supports its long term strategies, balance sheet composition and risk profile while also protecting the integrity of their respective insurance funds. The banking industry has regulated risk levels through risk based capital ratings. It is appropriate for credit unions to comply with some regulatory parameters to protect the National Credit Union Insurance Fund (NCUSIF). However, we do not believe that the risk inherent at natural person credit unions, including CAP COM, is significant enough to merit risk based standards comparable to banks. The capital preservation of natural person credit unions during the recent economic downturn is evidence that these credit unions were adequately capitalized with appropriate levels of risk monitoring and mitigation in place.

RBC2 makes a number of positive changes to RBC1's proposed risk weightings. Improvements include the removal of weighted average life components from risk weights for investments and changes to risk-weight escalation for higher concentrations of real estate and member business loans.

Unfortunately, RBC2's risk weights remain too high in key areas, given credit unions' level of risk. CAP COM disagrees with the risk levels that continue to be proposed in RBC2 as follows.

<u>CUSO Investments:</u>
Cap Com has diversified its investments in CUSO's amongst four entities providing products and services in:

1. Residential mortgage origination and servicing;
2. Investment and insurance services;
3. Residential and commercial real estate title insurance; and
4. Car buying services.

As of March 31, 2015, Cap Com FCU has invested a total of $6.0 million in these CUSO's and has recorded retained earnings of $11.1 million. Nearly two-thirds of member equity in these CUSO's is comprised of current and prior year profits. It is our opinion that these combined investments in CUSO operations do not pose a risk of 250% of our investment. Cap Com's strategic development of CUSO operations was deployed through organic growth as well as acquisition. The recent acquisitions resulted in both goodwill and intangibles being recorded.

As demonstrated above, CAP COM has effectively used its CUSO's in generating income and servicing other credit unions as part of its strategic plans for the past ten years. The RBC2 proposed by the NCUA suggests that the investment in these CUSO's presents substantial risk when, in fact, the performance of CAP COM's CUSO's have supported growth in the net worth ratio to its current level through annual profits and strong fiscal management. The NCUA has not substantiated the additional risk associated with CUSO operations and may force CAP COM to be obligated to risk based standards whose compliance will be costly and unnecessary.

Representatives from NACUSO have indicated that NCUA claims made relative to significant CUSO losses over the last decade are unsubstantiated. No detailed statistics have been provided to justify these losses as substantial, and NACUSO would challenge any such claim as we are not able to substantiate any losses of a significant nature through credit union investment in CUSOs over the past ten years and in fact find that such CUSO investment losses have been largely immaterial.

<u>Mortgage Servicing Rights (MSR):</u>
Risk based levels on MSR were not changed from the original RBC1 proposal and remain, in our opinion, higher than the related risk levels. The primary reason CAP COM has MSR on its books is to ensure that its members continue to be serviced by a credit union. The elimination of long term interest rate risk is achieved by selling the asset and the relationship is preserved by retaining the servicing rights. The NCUA is, in effect, penalizing credit unions by requiring the risk based standards an overly aggressive risk weight. To eliminate such risk would require credit unions to sell the member relationship with the simultaneous sale of both asset and servicing rights.

<u>Goodwill:</u>
It is our understanding that both RBC1 and RBC2 would require the subtraction of goodwill from capital in the RBC ratio. RBC2 would allow a credit union to include "supervisory" goodwill as part of capital, but this provision would expire in January 2025. The agency has defined a "supervisory merger" in a positive way to include mergers in which the agency or a state regulator has identified the continuing credit union even if no actual assistance for the merger was required.

Cap Com has been involved in mergers in the past and has carried goodwill and intangible assets associated with those mergers on its balance sheet in accordance with generally accepted accounting principles. This adjustment to capital puts Cap Com at a distinct disadvantage. It also creates a significant disincentive for credit unions to consider mergers at a time when consolidation within the industry is expected to increase. Thus, CAP COM believes that goodwill should not be immediately deducted from the numerator of the risk-based capital ratio. If deducted, the deduction should be phased out over a ten-year period. Further, goodwill arising from previous supervisory mergers should be grandfathered and allowed to be counted as risk-based capital without a time limit so long as it meets GAAP requirements. Credit unions that supported NCUA's programs to minimize losses to the NCUSIF in the financial crisis should not be penalized by a change in the rules after the fact.

The NCUA must acknowledge that the majority of mergers in the coming years will actually minimize and mitigate some of the risk to the industry as a whole as weaker credit unions are absorbed into larger and more sophisticated credit unions. Future mergers between credit unions may be adversely impacted by the unfavorable treatment of Goodwill under the proposed RBC2.

<u>Loans</u>
Under RBC2, risk weights on certain loans classifications have changed but remain higher than comparable asset classifications in banking regulations. Specifically, current first lien residential mortgage loans over 35% of assets would have a risk weight of 75%, actually higher than the 50% risk weight for banks. Current and non-junior real estate loans over 20% of assets would also have higher risk weights than provided for banks. Also, credit union commercial loans over 50% of assets would have a risk weight of 150% while the weighting for bank commercial loans over 50% of assets could be as low as 100%. These risk weights should be adjusted downward to levels no more than those in place for banks as credit unions certainly do not have higher levels of risk associated with holding these assets. Lowering risk weights for higher concentrations of real estate and commercial loans would imply lower risk weights for lower concentrations of these loans compared to bank risk-weights, but this is entirely appropriate given lower loss rates at credit unions.

<u>Investments</u>
CAP COM does not support the 300% risk weighting for publicly traded equity investments which should be much lower so that credit unions will not be unduly limited in their investments for employee benefit funding. CAP COM has implemented a conservative investment strategy that was put into place to offset the costs of rising employee benefits.

The performance of the portfolio is marginally better than the performance of the permissible investments held on its balance sheet but in no way represents a risk three times that of an existing fixed income portfolio. We urge NCUA to re-evaluate the risk weight for these investments.

Interest Rate Risk
It was CAP COM's strong belief in the original RBC1 proposal that assessing risk levels on the extension risk of assets was inappropriate and did not measure the true risk inherent in the credit union's balance sheet. Thus CAP COM approves of the elimination in RBC2 of higher risk weights for longer-term investments. However, NCUA intends to address interest rate risk (IRR) by issuing a separate proposal that would apply a common measurement framework on all credit unions with minimum quantitative measurements.

It is CAP COM's opinion that interest rate risk should not be incorporated into the risk-based capital system. NCUA already has an interest rate risk rule in place that provides adequate protection and measurement of interest rate risk through the examination process. The measurement and management of interest rate risk is specific to the individual credit union and a common framework would restrict management in developing cohesive strategies for asset liability management. If additional interest rate risk assessment processes are needed, the NCUA should address the risk via the examination process.

Capital Adequacy:
CAP COM strongly approves of the NCUA's change to eliminate the provision in RBC1 requiring individual minimum capital requirements (IMCR) but believes that provisions in RBC2 continue to restrict management in capital planning.

CAP COM understands that RBC2 would require a credit union to hold capital commensurate with its risks and would continue the authority of the NCUA Board to reclassify a credit union and if deemed below adequately capitalized, subject the credit union to supervisory actions because of safety and soundness. RBC2 would also add a requirement that a "complex" credit union maintain capital commensurate with the level and nature of all its risks, and have a process to determine its capital adequacy in light of its risk, as well as develop a comprehensive written strategy to maintain "an appropriate level of capital.

The proposed rule continues to provide the NCUA with the authority and ability to establish higher minimum risk-based capital standards for individual credit unions in any case where the circumstances indicate that a higher risk-based capital requirement is appropriate. Thus, CAP COM opposes the capital adequacy plan requirements in RBC2.

Strategic capital planning is very important for credit unions, and each credit union's long-term desired capital ratio will depend on the credit union's own assessment of the risks it faces, and it's tolerance for risk. CAP COM's position is based in part on its past performance and its own capital planning strategies. The net worth ratio as of March 31, 2015 was 11.15% increasing from 8.15% over the past five years. During that same period, CAP COM's consolidated total asset position increased $325.0 million or 38.5%.

Such a plan should not be the subject of examination and supervision, and the goals a credit union establishes for its own capital sufficiency should not become targets or standards in an examination.

Implementation Period
CAP COM approves of the delay in implementation of the proposed regulation to include a period of not less than four years from the date of the final regulation. An extended period is needed to ensure all credit unions can adequately and effectively address and measure the implications of the regulations on its individual balance sheets.

Conclusion
While CAP COM supports NCUA's effort to monitor industry risk through risk-based capital standards, we believe that the aforementioned areas of concern warrant change to the proposed rule.

We appreciate the opportunity to provide comments and for your consideration of CAP COM's position on this proposed rule.

Very truly yours,

David J. Jurczynski
Executive Vice President & CFO
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