CREDIT UNION DEPARTMENT

Harold E. Feeney
Commissioner

Robert N. Baxter II
Deputy Commissioner

April 27, 2015

Sent electronically to: regcomments@ncua.gov

Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314

RE: Prompt Corrective Action—Risk Based Capital; RIN 3133-AD77

Dear Mr. Poliquin:

The Credit Union Department, State of Texas is pleased to provide comments on the National Credit Union Administration's (NCUA' s) proposed modifications to NCUA Rules and Regulations Parts 700-703; 713, 723, and 747 regarding prompt corrective action and risk-based capital. By way of background, the Department is the state agency responsible for overseeing state-chartered credit unions operating in Texas.

The Department is generally supportive of NCUA's efforts to ensure the safety and soundness of the federally-insured credit union system through implementation of a risk-based capital framework. At the same time, we believe that several aspects of the proposed rulemaking would have harmful effects on the availability and cost of financial services to credit union members. Given the importance of credit union services to the Texas economy, the Department believes that further refinement is necessary to appropriately craft the proposed revisions to ensure a properly functioning and competitive system.

Supplemental Capital Should be Included in the Risk-Based Capital Numerator

Unless all federally-insured credit unions have the ability to meet the risk-based capital ratio requirements, as other financial institutions do, the proposed rule will create a more restrictive capital requirement that will place credit unions at a competitive disadvantage. Including supplemental forms of capital in the risk-based capital numerator should help protect the National Credit Union Share Insurance Fund (NCUSIF) from losses by encouraging more complex credit unions to attract additional loss-absorbing forms of capital that credit unions would otherwise forego. Texas statutes currently authorize credit unions to issue supplemental capital but there is a cost associated with such an issuance. Without that capital counting toward prompt corrective action requirements, Texas credit unions have no incentive to bear the cost. If supplemental capital were to count toward regulatory capital, it would benefit credit unions by allowing them to expand products and services without diluting regulatory capital, and it would protect the NCUSIF by providing incentives for credit unions to attract private capital that could absorb losses before causing harm to the NCUSIF. We, therefore, encourage NCUA to consider and incorporate supplemental forms of capital in the risk-based capital numerator. This could allow Texas and the other states that have previously authorized supplemental forms of capital the ability to serve as laboratories of experimentation and innovation as NCUA seeks a legislative solution that would redefine the net worth ratio.

Unconsolidated CUSO Investments Should be Weighted at 100 Percent

As with any investment, the Department understands that a credit union could incur a loss from an unconsolidated CUSO investment; however, we believe that NCUA should draw a distinction between CUSOs and private equity investments in banks. Based on significant powers of supervision asserted by both the NCUA and this agency, the Department does not believe that the 150 percent risk weight reflects a fair assessment of the actual risk held by most credit unions. In fact, given the limits on credit union investment powers, the vast majority of credit unions with unconsolidated equity investments in CUSOs would probably fall within the "non-significant" exception under the banking regulations for investments aggregating less than 10 percent of total assets, and would receive a 100 percent risk-weight. Accordingly, we believe that adjusting the CUSO investment weighting to 100 percent would better reflect the role of CUSOs in the credit union system while still aligning, in practice, with the treatment of similar exposures in other types of financial institutions.

Concentration Weightings Should be Removed from the Rule

Although NCUA has made the case that high concentrations of certain asset classes has been a significant factor in recent credit union failures, we are not convinced that a risk-based capital calculation is an effective means of addressing concentration risks. Placing credit unions at a competitive disadvantage to other financial institutions by requiring credit unions to hold incrementally more capital than other institutions given similar levels of asset concentrations is not necessary and will have limited value in providing early warning for truly unsafe concentrations. We believe that the examination framework and the timely application of supervisory actions would be a better course to address any truly unsafe concentrations. In addition, if for any reason NCUA feels its supervisory tools are not sufficient to deal with a given situation, it would still have the ability to apply the capital adequacy planning requirements of proposed Part 702.101(b) to a credit union that was exhibiting excessive concentrations levels. Accordingly, we urge NCUA to eliminate the proposed concentration risk threshold from the rule.

Additional Suggestion

We note and support NCUA's decision to remove the interest rate risk controls from the risk-based capital proposal. We do, however, have some reservations that NCUA seems compelled to issue a new proposal on interest rate risk, without first adopting the Uniform Financial Institutions Rating System as it was revised by the Federal Financial Institutions Examination Council in 1996 (commonly referred to as the CAMELS rating system). The CAMELS rating system incorporates examination considerations that are not explicitly noted in NCUA's current rating system. More specifically, adding the sensitivity to market risk component would strengthen NCUA's ability to assess interest rate risk in the examination process and thereby significantly improve the agency's response to interest rate exposures that could negatively impact a credit union's earnings and capital.

Under NCUA's current rating system, sensitivity to market risk is incorporated into the liquidity rating. As a result, a credit union with excessive interest rate risk but strong liquidity could still receive a satisfactory component rating despite a substantial supervisory concern. Separating interest rate risk from liquidity would allow NCUA to communicate its concerns about interest rate risk management to credit union leadership more effectively. It will also help NCUA to identify credit unions with severe interest rate risk exposure and focus its resources effectively to address those outliers.

The Department utilizes the CAMELS rating system and it is our opinion that it has resulted in improved assessment and supervisory communication regarding interest rate and liquidity risk exposure/management systems. The examination process has been enhanced through more open and complete discussion of the sensitivity to market risk component. These discussions have also provided credit union management with useful information for making more effective risk management decisions.

The Department hopes that these comments will assist NCUA in refining the proposed revisions and appreciates the opportunity to comment on these issues.

Sincerely,

Harold E. Feeney
Commissioner

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