MD|DC Credit Union Association

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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

Re: Comments on Proposed Rule: Risk Based Capital, 12 CFR Parts 701, 702, 703, 713, 723 and 747

Dear Mr. Poliquin:

Thank for your consideration regarding our formal comments from the MD|DC Credit Union Association on the National Credit Union Administration's ("NCUA") recent proposed rule, Risk-Based Capital ("Proposed Rule") issued on January 15, 2015. We appreciate the opportunity to share our concerns and recommendations regarding the Proposed Rule with the Agency.

The MD|DC Credit Union Association is a trade organization which represents 100 credit unions and nearly 2.2 million member-owners across Maryland, District of Columbia and region. We commend the NCUA for reviewing its initial proposal and substantially improving it. However, we believe the Proposed Rule as it is currently drafted still falls short of what is needed. We would like to cover the major areas of concern in the Proposed Rule and provide our recommendations for improvement.

Positive Points of the Proposed Rule

We would like to highlight the following positive aspects of the Proposed Rule which were changed from 2014:

a. Removing interest rate risk from the proposal;
b. Zero percent risk weight for cash held at the Federal Reserve;
c. Extended implementation period;
d. Concentration thresholds were reduced from three to one tier for residential mortgages, junior liens and MBLs.
e. Removal of ALLL cap;
f. Lowers well-capitalized threshold from 10.5% to 10%; and
g. Removal of Individual Minimum Capital Requirement ("IMCR").

Opportunities for Continued Improvement of the Proposed Rule

The following focuses on areas of the Proposed Rule which are concerning and we would like to see removed or modified:

1. The NCUSIF deposit should not be a deduction from the risk-based capital numerator.
2. The concentration risk penalty for first mortgage loans and junior liens should be eliminated.
3. Investments in Credit Union Service Organizations ("CUSOs") should have similar risk weights as Loans to CUSOs.
4. The Proposed Rule is a complete overhaul of current credit union capital standards, thus it would be appropriate to incorporate a supplemental capital provision into the regulation and put it out again for further public comment.
5. The costs associated with the proposal outweigh the benefits.

Section-Specific Comments
In the following sections (in order by section number), we have highlighted in more detail the more problematic aspects of the Proposed Rule.

<u>Section 702.104(b)(2) Risk-Based Capital Numerator Deductions:</u>

The Proposed Rule deducts the NCUSIF deposit from the risk-based capital numerator. It is not clear as to what the NCUA's intent is regarding the NCUSIF deposit. Desert Schools interprets this section as somehow trying to make the numerator similar to banks, in that, they expense their insurance premiums as they pay them on a quarterly basis. The flaw in this methodology is the fact that banks do not have a deposit held at the FDIC, but rather pay a quarterly premium that is non- refundable.

There are many scenarios under which a credit union could have its NCUSIF deposit returned such as: conversion to a mutual savings association, election of private insurance rather than NCUA coverage or voluntary liquidation. GAAP recognizes this deposit as an asset; therefore, it does not make sense to treat the deposit as an intangible asset given that it is easily measured and can be returned or refunded.

<u>Recommendation</u>
The NCUSIF deposit should not be deducted from the risk-based capital numerator or the risk-based asset denominator.

The deposit is under the NCUA's control and it is supplementary to the capital available on a credit union's books in case of failure. Therefore, it should remain part of the risk-based capital numerator.

The risk of loss to this asset is minimal given the fact that it is under the NCUA's control, again supporting the notion that the risk-weight should be zero.

<u>Section 702.104(c)(2) Risk-Weights for On-Balance Sheet Assets:</u>

First Mortgage Real-Estate Loans (Excluding Commercial Real Estate):

Historically, first mortgage loans have been a stable, low credit risk asset and a primary asset for a credit union's presence and mission in their communities. It is important to acknowledge the significant losses credit unions have incurred during the housing crisis and the significant progress that has been made since in underwriting and risk mitigation. High-risk mortgages currently make up very little of the loan production of credit unions. New legislation, such as the Dodd-Frank Act, and the creation of the Consumer Financial Protection Bureau (CFPB) have changed the mortgage industry landscape by reducing the probability of questionable underwriting in the future that could cause extensive losses and a repeat of the recent market turmoil.

A down side to the increase in regulation is the increased burden and costs to originate a qualified mortgage. The Proposed Rule would exacerbate the burden and costs by requiring higher levels of capital for those credit unions that hold first mortgage assets in excess of 35% of total assets. The increased capital cost based upon concentration risk puts credit unions at a competitive disadvantage to other financial institutions that do not have higher risk-weighting for concentration of loans.

Recommendation

Eliminate the higher risk-weights for concentrations of residential first mortgage loans. Credit unions and their members will both benefit by not increasing their costs to fund these loans and credit unions will not be at a competitive disadvantage to other financial institutions.

Junior Liens:

As the housing market continues to recover, junior liens are becoming an important financial tool for homeowners to use. Similar to first mortgages, the concentration component above 20% of total assets for second mortgages puts credit unions at a competitive disadvantage to other financial institutions that do not have higher risk- weighting for concentration of loans.

Recommendation

Eliminate the higher risk-weights for concentrations of junior liens. This will ensure that credit unions will not be at a competitive disadvantage to other financial institutions.

Investments in CUSOs:

CUSOs promote collaboration and risk sharing within a credit union structure and have been largely successful over the years. While there have been some losses since 2008 in CUSOs, the losses stemming from the holdings are substantially smaller than losses experienced in loan portfolios or corporate credit union related exposures.

CUSO investments are proposed to have a risk-weight of 150% irrespective of the type of business that is conducted by a particular CUSO. Given the range of services that a CUSO can perform (and inherent risk associated with that service), this risk-weight seems arbitrary and punitive depending on the type of service provided by a CUSO. For example, a CUSO specializing in member business loans would typically have a higher risk profile than an investment services CUSO and certainly more risk than a CUSO that supports the back office.

Further, the FDIC defines non-significant investment exposures in unconsolidated equity of a privately held company in aggregate of 10% or less of a bank's capital (risk weighted at 100%). Federal credit unions are limited by statute or regulation to a maximum aggregate investment in CUSOs to 1% of shares minus any regular or special reserves. Given that over 97% of all federally insured credit unions were well capitalized at the end of 2014, most investments in CUSOs (even when maxed out at 1% of shares) would fit the definition of non-significant by the FDIC and should thus be risk-weighted at 100%.

Another deficit of the CUSO risk-weight proposal is that the 150% risk-weight is based upon current value of the CUSO investment, rather than the initial investment, thus penalizing growth (or success) in investment value.

Recommendation
Bring the risk-weight in line with Loans to CUSOs as well as non-significant investments in unconsolidated equity for banks (100%) under the Proposed Rule and only apply the risk-weight to the original investment amount in the CUSO. This would be much more consistent with the inherent risk of the investment and serve not to penalize success of the CUSO. Further, the NCUA board recently passed the final CUSO regulation which authorizes them to regulate the investments and loans a credit union makes to a CUSO. This enhanced authority and oversight support a lower risk-weight.

Other Areas of Concern

Supplemental Capital:
A credit union's net worth ratio is currently determined solely on the basis of retained earnings as a percentage of total assets. Because retained earnings often cannot keep pace with asset growth, otherwise healthy growth - such as growth resulting from taking deposits – can dilute a credit union's regulatory capital ratio. Allowing eligible credit unions access to supplemental capital, in addition to retained earning sources, will help ensure healthy credit unions can achieve manageable asset growth and continue to serve their member-owners efficiently. The increased capital burden under this proposal heightens the need for supplementary capital.

Recommendation
We respectively request that NCUA actively support legislation to allow federal credit unions to receive payments on uninsured, non-share capital accounts provided the accounts:

- Do not alter the cooperative nature of the credit union;
- Are uninsured;
- Are subordinate to all other claims against the credit union, including the claims of creditors, shareholders, and the NCUSIF;
- Are available to be applied to cover operating losses of the credit union in excess of its retained earnings and, to the extent supplied, will not be replenished;
- Are subject to maturity limits as determined by the NCUA; and
- Are offered by a credit union that has been determined sufficiently well capitalized by the NCUA.

Impact on State Chartered Credit Unions:

We strongly urge the NCUA to develop a coordinated strategy with all state regulators relative to the promulgation of any changes to capital rules. Our member credit unions have at times witnessed differences in regulatory interpretations between the NCUA and state regulators. In addition, the supervision of the NCUSIF always seems to be the driving factor for the NCUA to take a lead position or justify its application of a rule to Association members, whose state chartered credit unions are all federally-insured. The loan participation and emergency liquidity rules are recent examples of the exercise of such authority.

In addition, there are many state laws and regulations that will impact the application of the final RBC rule for credit unions. Furthermore, it is expected that the required NCUA call report changes anticipated under RBC will have a direct impact on these provisions and a coordinated strategy amongst regulators will greatly reduce the compliance and regulatory burden on credit unions.

Recommendation

Concern clearly exists that state chartered authority may be undermined through the adoption of a final RBC rule. The Association strongly urges all regulators to agree and clearly disclose to state chartered credit unions their final determination as to who is responsible for establishing, monitoring and enforcing the capital plan.

The Association also notes that many state chartered credit union regulators, such as those that supervise Association members, also serve in a dual capacity working with other federal regulators and insurers of banks. Assuming RBC proceeds, we urge the NCUA to take the necessary steps to promote consistency and minimize confusion in both process and substance which may arise in any final risk-based credit union capital provisions.

High Cost of Proposal:

If finalized, the Proposed Rule will impose very high costs on the credit union industry. NCUA estimates that this proposal will cost credit unions roughly $5.1 million to review the rulemaking and make necessary changes to current policies. Looking further ahead, the NCUA also projects that it will cost $3.75 million for the agency to adjust the Call Report, update its examination systems and train internal staff to implement the proposed requirements. The NCUA also estimates credit unions would incur an ongoing $1.1 million expense to complete the adjusted Call Report fields. What is not estimated by the NCUA are the one-time costs that will be incurred by the entire credit union industry in system changes, additional reports, potential additional segregation and segmentation of the balance sheet, etc. in order to fill out the new call reports.

We believe those costs will far outweigh (by orders of magnitude) the costs that the NCUA has identified. We find it curious that such costs were not even attempted to be estimated by the NCUA. The very fact that they (as one organization) will incur nearly $4 million in conversion expenses should raise a “red flag” at the expenses that will be incurred by thousands of individual credit unions.

According to the NCUA, complex credit unions are substantially well capitalized under both net worth ratio and RBC ratio. As of September 30, 2014 complex credit unions had an average net worth ratio of 10.7% and RBC ratio of 19.3%, both well in excess of guidelines identifying well capitalized status. Further, only 19 complex credit unions would fall from well capitalized status under the proposal. Therefore, the costs associated with the proposal seem excessive given how extremely well capitalized the credit union industry is today under current guidelines. The proposal seems to be an inappropriate use of credit union resources to address concerns about a few outliers. The NCUA would be better served by focusing on credit unions on an individual basis under existing powers.

Recommendation

The proposal should be revamped to reduce the initial and ongoing costs or completely eliminated. Current standards are sufficient to regulate from afar. Credit unions that require closer scrutiny can be handled through the normal examination process.

Conclusion

As previously stated, the NCUA's revised proposal to create a risk-based capital standard is a step in the right direction. However, the Proposed Rule as written would still have significant negative capital consequences to credit unions and could place them at a competitive disadvantage to banks. If the Proposed Rule is implemented as it currently stands, credit unions may out of self-preservation seek bank charters where risk-based capital requirements are much more consistent in their treatment of asset classes and much less punitive.

The recommendations contained in this comment letter would improve the Proposed Rule and allow credit unions to confidently operate under this new standard. These recommendations would also give the NCUA peace of mind that credit unions have sufficient capital to operate in a safe and sound manner and provide competitive products to their members in comparison to other financial institutions such as banks.

Thank you for the opportunity to comment on the Proposed Rule on the risk-based capital requirements. Please do not hesitate to contact me at 443-325-0774 or jbratsakis@mddccua.org should you have any questions.

Sincerely,

John Bratsakis

John Bratsakis
President/CEO
MD|DC Credit Union Association
8975 Guildford Rd., Suite 190
Columbia, MD 21046