April 20, 2015

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

Delivered Electronically

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

Dear Mr. Poliquin,

The Northwest Credit Union Association (Association)[1] is pleased to be able to offer comments on the National Credit Union Administration's (NCUA) second Risk Based Capital proposed rule (RBC2). The Association appreciates the NCUA board and staff support of a modern regulatory system that allows credit unions to thrive in both present and future market conditions.

The Association commends the NCUA board and staff for making substantial changes to the initial proposal based on the public comments they received. Specifically we thank the Agency for among other things, lowering the Risk Based Capital (RBC) ratio level required for an affected credit union to be classified as well capitalized from 10.5 percent to 10 percent, lowering the risk weights for various classes of assets, removing interest rate risk components from the risk weights, and extending the implementation timeframe to January 1, 2019. These changes substantially reduce the number of credit unions subject to the rule, reduce the impact on affected credit unions, and afford affected credit unions sufficient time to prepare for the rule's implementation.

While we still have some concerns about the rule as proposed, we appreciate the leadership of Chair Matz and the willingness of the NCUA board to address valid concerns.

Background:

On Thursday, January 15, the NCUA board approved a second Risk Based Capital proposal in a 2-1 vote. The proposed rule was published in the Federal Register on January 27 with a 90 day comment period.

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[1] The Northwest Credit Union Association is a regional trade association representing the interests of more than 200 credit unions and their six million consumer-members; institutions that employ and engage more than 10,000 people and hold more than $50 billion in aggregate assets. The Association is a nonpartisan advocacy organization representing the interests of its member institutions on a variety of systemically important banking issues.

Credit unions affiliated with the Association are principally domiciled in the Northwest quadrant of the United States, but the Association also has members from the states of Alaska, Idaho, California and Hawaii. Learn more about the Association at www.nwcua.org.

The proposal would revise and replace NCUA's current prompt corrective action (PCA) rules. The revisions replace the current risk-based net worth ratio with a new risk-based capital ratio for federally insured natural person credit unions.

In addition, the proposed revisions require higher minimum levels of capital for credit unions with concentrations of assets in real estate loans or commercial loans. The proposed revisions would also eliminate several provisions in NCUA's current PCA regulations, including provisions relating to the regular reserve account, risk-mitigation credits, and alternative risk weights.

To assist the NCUA in their effort to create a modern capital system we sought input from our members through a number of different avenues including our NWCUA Regulatory Advisory Subcommittee. Our recommendations focus on improving some technical aspects of the proposed rule.

General Comments

The NCUA has taken a positive step by demonstrating a willingness to create a modern Risk Based Capital system for credit unions. A final rule that takes into account the comments and concerns of responding credit unions will be viewed positively by credit union leaders.

We appreciate that the NCUA put together a collaborative industry/regulator workgroup with representation from the Northwest. The Association supports this highly effective process and strongly encourages the NCUA to continue using collaborative work groups for future rulemakings. We appreciate the time, thought, and work of the workgroup members. We acknowledge Kevin Cole and Susan Streifel, work group participants from the Northwest. We also recognize the NCUA's Steve Farrar, JeanMarie Komathy, Larry Fazio, and others who worked diligently to improve the initial proposal.

This is a major rule that impacts credit unions' bottom lines, the mix of products and services offered, and the makeup of their balance sheets. To maintain a healthy credit union industry it is critical that the NCUA exempt non-complex credit unions with less than $250 million in assets. Furthermore minority depository institutions, low income designated credit unions, and certified community development financial institutions should be exempted from this rule, as they are not complex, but have higher risk profiles due strictly to the membership they serve. Applying this rule to credit unions serving vulnerable populations would disparately impact the communities these credit unions serve.

Legal Hurdle

The Association was pleased that NCUA reduced the well capitalized requirement from 10.5% to 10%. However, the 10% Risk Based Capital requirement is still not an equivalent standard. Banks have an 8% total risk-based capital ratio plus the 2.5% capital conservation buffer. However, the capital buffer is not part of the PCA buffer and does not affect the rating. Furthermore the FCUA requires the NCUA Board to take into account that credit unions do not issue capital stock, must rely on retained earnings to build net worth, and have boards of directors that consist primarily of volunteers. Finally, when the regulation was initially drafted they did account for the factors mentioned above creating a single RBC requirement to be adequately capitalized.

The only way that a 10% RBC requirement could be considered equivalent is to allow credit unions to count secondary capital for RBC purposes. The Association appreciates Chairman Matz's consistent support and recognition of the importance of secondary capital. In particular, her recent remarks at CUNA's Governmental Affairs Conference in Washington DC, where she stated.

> "I assure you, as part of modernizing risk based capital, I am committed to allowing supplemental capital to be counted in full. I am open to proposing rules to accommodate these forms of supplemental capital through regulatory changes. These effective dates would coincide with the implementation of risk based capital in 2019."

However, if secondary capital does not count, the NCUA would need to adopt a single risk based calculation requirement for adequately capitalized which should be 8%, and remove all references to well capitalized from the risk based rule, leaving the current structure in place.

Specific Concerns

The Association has reached out to our membership soliciting input on specific issues of concern. Some of the most common points made by credit unions are that the definition of complex is not in line with what accurately represents a complex credit union, and fear that a separate interest rate risk rule will negatively impact credit unions. Numerous credit unions have shared that the proposed rule would significantly impact their strategic plans and how they grow, even though they are well capitalized. This is particularly true for credit unions with less than $250 million in assets that need to grow in order to achieve economies of scale.

Definition of complex credit union:

The NCUA's proposed standard to define credit unions as "complex" if their quarter-end total assets exceed $100 million is a step in the right direction. However, concerns remain. In the updated proposal the NCUA provided a list of activities that they considered complex, most of which are essential operating activities of nearly any viable credit union. The list included internet banking, real estate lending, indirect lending, investments with greater than five year maturities, and borrowing.

As a rule, credit union balance sheets are not complex. Even the most complex credit unions have a different mix of products and services with far less exposure to high risk activities than other types of financial institutions. Examples of these high risk activities include trading, private equity, and counterparty exposure from derivatives and financing transactions. Furthermore, exposure to commercial real estate and commercial industrial lending is almost nonexistent.

To survive and achieve economies of scale credit unions need to innovate and adapt and should be encouraged to offer new products and services. We have concerns about a rule that incentivizes credit unions to limit their product and services offering.

We strongly encourage the NCUA to define credit unions with $250 million in assets or more as complex, to encourage mid-size credit union growth. In the final liquidity rule the NCUA used an asset threshold of $250 million for the requirement to join the Central Liquidity Fund (CLF) or Fed Discount Window. Stating that:

> "credit unions over $250 million have a greater degree of **interconnectedness** with other market entities. When they experience unexpected or severe liquidity constraints, they are more likely to adversely affect the credit union system, public perception, and the **NCUSIF**."

The statement above is a defensible definition of complex, consistent with the intent of the Federal Credit Union Act.

If the NCUA uses a mix of products and services to define a complex credit union, those products and services should actually be complex and require both credit union and examiner expertise to understand. For example, non-agency mortgage backed securities, non-mortgage-related securities with embedded options, CMO's/REMICs, and derivatives are investments that define a more complex credit union.

Additionally the Association supports exempting low income credit unions (LICU), minority depository institutions (MDI), and community development financial institutions (CDFI). These credit unions are focused on serving higher-risk, underserved members who would be disparately impacted by the proposed capital rules, which discourage lending to the very individuals these institutions serve.

Supplemental/Secondary Capital

Currently more than 2000 credit unions of all asset sizes have low income designations and can access secondary capital. Only a handful of credit unions take advantage of these opportunities as the current requirements limit the options and make it unattractive to investors and cost prohibitive to credit unions.

The NCUA recently took an important initial step to improve the secondary capital framework by making changes to the National Supervision and Policy Manual, creating an expedited approval process, and the ability to redeem secondary capital that no longer counts toward net worth for CAMEL 1 & 2 credit unions. Additionally, Chair Matz announced late last year that the NCUA had formed an internal work group to help design a modern secondary capital model. We appreciate that the workgroup is underway and has reached out to additional stakeholders, including the Association.

The Association's board adopted the following position statement related to secondary/supplemental capital:

> The Association supports the idea of supplemental capital and urges the adoption of legislative changes that would allow all credit unions to accept supplemental capital and count it toward regulatory net worth requirements.

The Association and our member credit unions strongly support a legislative and regulatory regime that allows supplemental capital. We believe two key tenets should guide the NCUA: preserve the cooperative model, and provide investor safeguards and optionality that reduces the cost of capital for credit unions.

The Association supports the dual chartering system which allows for the incubation of new powers and authorities and promotes self determination. As such we would encourage the NCUA to allow state supervisory authorities the ability to create their own secondary capital frameworks, which is currently prohibited by 741.204(d). The NCUA has the discretion to update this and at a minimum should allow states to submit a proposed rule for approval to the NCUA. This would not be a new precedent as states currently have the authority to submit an MBL rule for approval.

In addition, we believe fundamental regulatory changes should be adopted for secondary capital and that all credit unions should be able to offer secondary capital instruments for risk-based purposes. First and foremost we believe that the NCUA should remove the prohibition on natural persons investing in secondary capital instruments.

Anecdotally, we are aware of a situation where an individual wanted to make an at-risk investment in a low income designated credit union to help them achieve their social mission and expand their ability to lend to folks in an inner city community, and unfortunately this was not permissible.

Credit unions have reported that some of their members are looking for a place to invest with higher yields than ten year treasuries and a lower risk profile than the market. These individuals should be allowed to make at-risk investments in healthy, well managed credit unions as long as the disclosures are very clear and conspicuous. In general, issuing longer maturing capital is more expensive than issuing shorter duration capital so credit unions should be able to set the terms to match maturities of the risks they are intending to hedge. A good example of this type of instrument would be an uninsured term deposit.

Credit unions should have the option to convert required membership shares into secondary capital. These deposits currently function similarly to permanent capital. Converting membership shares into uninsured deposits would help insulate the NCUSIF against losses, and would allow the credit unions to leverage these deposits to benefit members. From a RBC perspective this would allow all credit unions to benefit as they would be able to use the uninsured membership share to improve their RBC ratio while not negatively impacting their net worth.

The current secondary capital framework needs to be updated to make it attractive to investors, credit unions, and natural persons. Without secondary capital for RBC purposes, credit unions would be put at a competitive disadvantage to other types of financial institutions. As a result, less capital would be accumulated and portfolios with short durations would cause significant earnings volatility during future interest rate cycles.

Once again, if secondary capital does not count for RBC purposes, the NCUA would need to adopt a single risk based calculation requirement for adequately capitalized which should be 8% (equivalent to banks), and remove all references to well capitalized from the risk based rule, leaving the current structure in place.

Interest Rate Risk

The Association appreciates that the NCUA removed interest rate risk (IRR) from the RBC proposal. We believe that the current rule is sufficient and that examiners have the tools they need to supervise interest rate risk.

All complex credit unions agree that interest rate risk needs to be actively managed. Credit unions of all sizes are carefully monitoring balance sheets and performing rigorous IRR modeling that meets industry standards. They are also tracking key economic indicators that could negatively impact investment performance.

While we do not support a separate rulemaking that would amend the interest rate risk regulations currently in place, we support clear guidance that is available to both credit unions and examiners that outline the types of modeling, assumptions and measurements that the NCUA is willing to accept so that results can be measured against credit union peers.

While equivalent testing and scenarios are acceptable, credit unions' boards and management need to determine the level of risk they are willing to take, not examiners. Examiners also need to understand that the results of testing represent hypothetical extremes, rather than likely outcomes.

The regulatory focus on interest rate risk in the Northwest led to a handful of credit unions being strongly encouraged to rid themselves of some of their longer term performing assets which has created the most hostile relationship between the regulators and regulated in the past five years. At a recent meeting, a credit union leader mentioned that they had lost over $5 million dollars because the examiners had put significant pressure to sell an asset, due to an imminent rising interest rate environment. In this case it seemed to the credit union that the agency was using IRR to achieve a predetermined agency goal. To date this NCUA practice has caused harm and losses to credit unions and their members, setting up a negative dynamic and a loss of trust.

Once again, we caution against a rule but strongly encourage proper training, clear guidance and published scenarios that the NCUA will be asking credit unions to perform.

CUSOs

The Association supports the position taken by NACUSO that investments and corporate perpetual capital in non-wholly owned CUSOs should be risk weighted at 100% instead of 150%.

NACUSO points out that:

> The CUSOs that are owned by more than one credit union are providing much needed economies of scale, helping to obtain levels of expertise that an individual credit union may not be able to afford or obtain on their own, while helping to share/spread risk and lower costs. Assigning an unjustifiably high risk weighting to these multi-credit union owned CUSOs, which are important collaborative tools for our industry, is not reflective of the actual systemic risk CUSOs pose. Overall, based on the 2014 data, federally insured credit unions in total have only 17 basis points of their assets invested in CUSOs, and this number includes the fully consolidated CUSO investments! Clearly CUSO investment is not a systemic risk to the NCUSIF.

We would encourage the NCUA to consider the actual risk in relation to the investments and the exposure to the share insurance fund, and assign a 100% risk weight.

Capital Adequacy

The Association was pleased that the NCUA removed references to the individual minimum capital requirement, recognizing that they had the authority to reclassify a credit union's net worth under 702.102(b), which has safeguards that protect a credit union from being subjectively reclassified, without recourse. However the NCUA has proposed a new subjective capital adequacy provision 702.101(b).

> 702.101 – New Provision
> (b) Capital adequacy. (1) Notwithstanding the minimum requirements in this part, a credit union defined as complex must maintain capital commensurate with the level and nature of all risks to which the institution is exposed.

All credit unions consider liquidity and capital adequacy in strategic plans, but ultimately it is the responsibility of boards and management to determine the appropriate level of capital to hold commensurate to risk. Examiners currently evaluate liquidity and capital during the exam process and have the supervisory tools to deal with concerns. At a minimum, the NCUA would have to develop supervisory guidance, which could still be misapplied. The Association would encourage the NCUA to remove this provision in the final rule.

Additional AIRES Reporting

During a past NWCUA Regulatory AdvisorySubcommittee meeting, it was suggested that increased data collection beyond what is currently required in the call report would be preferable to being required to hold more capital than is actually necessary. In subsequent conversations credit unions not subject to the RBC regulations have expressed concerns about providing more detailed information as well as new information on the call report. We would encourage the NCUA to provide credit unions not subject to the rule an exemption from providing additional data.

Many of these credit unions have less than five employees and would face significant logistical and financial challenges with providing more detailed data. At a minimum we would encourage the NCUA to exempt non complex credit unions from additional reporting requirements.

Net Worth Restoration Plan

The NCUA's proposed risk-based capital rule adds a concerning requirement related to submitting a Net Worth Restoration Plan (NWRP), and misapplies this provision to credit unions that were led to believe they were not subject to the rule (see proposed change in red).

The provision states:

> (4) Submission of multiple unapproved NWRPs. Complex credit unions that submit more than two NWRPs that are not approved is considered an unsafe and unsound condition and may subject the credit union to administrative enforcement actions under section 206 of the FCUA, 12 U.S.C. 1786 and 1790d.

A number of credit unions have not done an in depth analysis on this proposal because the NCUA led them to believe that this rule would only apply to complex credit unions. An additional concern is that the NCUA has a lot of discretion on whether or not to approve a NWRP even if a credit union submits a plan that meets the stated requirements. The NCUA should include safeguards to ensure that credit unions acting in good faith are able to successfully submit a NWRP. To this end, should the NCUA adopt a rule without the proposed change outlined above, standards need to be adopted and assistance provided to all credit unions that are not considered complex, and eliminate ambiguity.

Conclusion

Credit unions do not operate under the transactional banking model. We provide relationship-based financial services to our members. Not only do credit unions know their members, but they are a part of their communities. This is another factor that makes credit unions inherently less risky and is not accounted for in the risk weightings of the proposed rule.

In conclusion we ask that:

1. The NCUA must allow credit unions access to secondary capital, or remove the well capitalized definition and;
2. Revise the asset threshold for which RBC applies to more accurately reflect complex credit unions, exempt LICUs, MDIs and CDFIs which could be disparately impacted by the rule and;
3. Remove the capital adequacy provisions since the NCUA already has the authority under §702.102b, with appropriate safeguards to reclassify a credit unions net worth and;
4. Issue Interest Rate Risk guidance rather than a rule;
5. Address technical issues with CUSOs,
6. Ensure that additional reporting requirements do not negatively impact non-complex credit unions not subject to the rule, and;
7. Make sure that non-complex credit unions are fully exempted from this rule.

Once again, we believe in the leadership of Chair Matz, Vice Chair Metsger, Board Member McWatters and their willingness to address valid concerns. The Association appreciates the opportunity to submit comments on the proposed stress testing and capital planning rule. We appreciate the NCUA's commitment to improving the regulatory landscape for credit unions. Thank you for the opportunity to comment on this issue. We would be pleased to answer any questions you may have.

Respectfully,

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