April 27, 2015

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

RE: Risk-Based Capital Proposed Rule
RIN 3133-AD77

Dear Mr. Poliquin,

Below are my comments regarding the Risk-Based Capital Proposed Rule.

NCUA's Lack of Authority for a Two-Tiered System

There continues to be concern regarding the NCUA's authority to create a two-tiered system. The overriding issue related to this is the legal authority of the NCUA to establish an additional regulatory requirement related to Risked-Based Net Worth (RBNW) for a "well capitalized" credit union meeting the definition of "complex". While there are numerous legal arguments related to if the legal authority exists to implement this regulation, the intent of Congress when the law was enacted should prevail. Based on comment letters from Former Speaker of the House, Honorary Newt Gingrich (May 23, 2014)[1], and Former Senate Banking Committee Chairman, Honorary Alfonse M. D'Amato (May 7, 2014)[2], the current proposal is inconsistent with the intent of Congress. Who better to understand the intent, than the two congressional leaders responsible for the passage of HR 1151.

Despite the belief that this Proposed Rule goes beyond the authority provided to the NCUA by Congress, the following comments are based on the likelihood that the NCUA chooses to move forward with implementation of a Risk-Based Capital (RBC) rule.

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[1] http://www.ncua.gov/Legal/CommentLetters/CLRisk20140507AD'Amato.pdf
[2] http://www.ncua.gov/Legal/CommentLetters/CLRisk20140523NGingrich.pdf

Unnecessary Regulation

There is no clear basis for disregarding the current prompt corrective action (PCA) regulations and adopting a completely different model. There were no issues identified as part of the NCUA's most recent review of the regulation performed as part of the NCUA's rolling three-year review of regulations in 2012. This analysis was performed subsequent to the NCUA's December 19, 2011 response, included in the January 4, 2012 United States Government Accountability Office (GAO) Report to Congress (GAO-12-247)[3]. This response by Chairman Matz, indicated:

> It is also worthy to note that consumer credit unions performed very well during the worst financial crisis since the Great Depression, and NCUA was highly successful overall in mitigating failures and losses for consumer credit unions. The 85 consumer credit union failures occurred over a two and a half year period during the height of the economic crisis. As noted in the report, the level of annualized failures is relatively low, only marginally higher than pre-crisis levels, and involved institutions with less than 1% of total credit union assets. NCUA was effective in prioritizing our supervisory resources during the economic crisis to prevent the failure of larger credit unions that came under stress, and in mitigating losses for those that did

In late January 2013, the NCUA's Office of General Counsel released the list of regulations being reviewed, indicating "Regulations under review in 2013 include rules governing member business loans, fair credit reporting, privacy of consumer financial information, appraisals and share insurance. ….. Additionally, NCUA will expand its review of federal credit union bylaws, which began in 2012." Based on this release, it would appear the PCA review was completed in 2012, since it was not expanded into 2013.

The NCUA suggests that the Proposed Rule was written to be more consistent with Other Federal Banking Regulatory Agencies (Other Agencies). The overall credit union industry has consistently been devoted to servicing their members differently than banks. Credit unions have proven to be an economic force in local markets and softened the effects of the recent economic downturns to its members. The overall credit union industry is not looking to be more consistent with banks and has devoted time to being a cooperative in nature.

Asset Size Should Not Define a Credit Union as Complex

The Federal Credit Union Act (FCUA) provides that the NCUA may only adopt RBNW rules for "insured credit unions that are complex, as defined by the Board based upon the portfolios of assets and liabilities of credit unions."[4] While the increased threshold of $100 million represents

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[3] http://www.gao.gov/assets/590/587409.pdf United States Government Accountability Office – Report GAO-12-247 – January 2012
[4] http://www.ncua.gov/Legal/Documents/fcu_act.pdf (Page 82)

progress, it still disregards the composition of assets and liabilities of individual credit unions. A more detailed definition of "complex" is warranted.

In addition to the above considerations, I recommend the NCUA increase the proposed asset threshold from $100 million to $1 billion. This threshold should be used in combination with actual operational complexity as measured by the NCUA's Complexity Index. The NCUA discussed a Complexity Index as part of the supplemental information. Thus, it is proposed that all federally insured credit unions with assets under $1 billion be considered non-complex, and that only those credit unions with assets above $1 billion and a Complexity Index value of 20 or higher be required to meet risk-based capital provisions.

Requirements for Capital Adequacy is Unclear

The Proposed Rule requires that "complex" credit unions "must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital" and "the nature of such capital adequacy assessments should be commensurate with the credit union's size, complexity, and risk-profile." The requirement for credit unions to have a comprehensive written strategy poses excessive regulatory burden to credit unions (see **Significant Under Estimation of the Regulatory Burden** discussed later in the letter) and the ruling is too vague. There are no clear guidelines and/or criterions of an NCUA's defined "comprehensive written strategy" for credit unions and NCUA examiners within the proposed regulation. This results in inconsistently applied requirements throughout the NCUA and its regions. Credit unions already have adequate capital adequacy policies, processes and procedures in place, therefore the NCUA should remove the requirement of a written strategy from the RBC rule. Furthermore, this proposed requirement appears to be a strong resemblance to the Capital Planning and Stress Testing rules issued last year for credit unions with assets of $10 billion or more.

Significant Under Estimation of the Regulatory Burden

The Proposed Rule's Paperwork Reduction Act estimates the additional data collection requirements for an estimated 1,455 complex credit unions to be a one-time 40 hour burden, or $1,276 cost per credit union. The Proposed Rule does not incorporate the estimated burden for establishing a comprehensive written strategy for maintaining an appropriate level of capital and other changes to the credit union's operations other than data collection. The effects of this proposal will be a much greater burden on complex credit unions upon the implementation year and for ongoing years. The NCUA's final rule on Capital Planning and Stress Testing estimated 750 hours of paperwork burden in the initial year and 250 hours in subsequent years[5].

Other than submitting a plan to the agency, it is unclear how the requirements of this proposal differ from the final rule on Capital Planning and Stress Testing. Using the cost estimate

[5] http://www.ncua.gov/Legal/Documents/Regulations/FIR20140424CapitalPlanningStressTesting.pdf (Page 24315)

previously utilized by the NCUA, a more reasonable estimate (compared to zero) would be $23,926 per credit union or $34.8 million to the industry for the initial year of the final RBC rule. Additionally, there would be an ongoing annual cost of $7,975 per credit union or $11.6 million to the industry. Over a five year period, the cumulative cost to the industry would be approximately $81.2 million.

Decrease the Minimum Capital Requirement

The NCUA's effort to decrease the minimum RBC requirement from 10.5% to 10.0% in the revised Proposed Rule is appreciated, but further reduction is necessary. The NCUA's basis for the minimum capital requirement was mainly derived from Other Agencies' regulation. The ruling does not consider the uniqueness of credit unions when deriving the minimum RBC requirement.

The overall credit union industry is not looking to be more consistent with banks and has devoted time to being low-risk, cooperative institutions. The strong performance of credit unions throughout the financial crisis demonstrates there is no need for significant RBC requirements. This is consistent with Chairman Matz's statement in the GAO Report to Congress (GAO-12-247) as referenced above. The NCUA should further decrease the minimum RBC requirement prior to implementation of a final rule.

Implementation of the Final RBC Rule Should be Beyond 2019

Thank you for recognizing an effective date of eighteen months was not reasonable. The Proposed Rule has an effective date of 2019, or approximately four years. It is unclear when the NCUA will implement the changes needed on the Call Report system to require information for calculating the RBNW under the final RBC rule. Other Agencies provided seven years with a phase-in requirement. Should the NCUA choose to continue utilizing Other Agencies as a guideline for this Proposed Rule, the final rule should have a similar seven-year implementation period or beyond.

The year of the liquidation of the Temporary Corporate Credit Union Stabilization Fund (TCCUSF), which is scheduled to occur in 2021, should be an additional consideration for the NCUA to further delay the implementation of the final RBC rule. The final rule's implementation date should coincide with TCCUSF liquidation to enable this distribution to become part of the calculation in determining a credit union's RBNW.

Align Risk-Weights for Credit Unions Not Banks

The revised RBC Rule from the original proposal has many positive changes, such as the removal of the cap for the allowance for loan losses and changes to real estate loans risk-weights. Nonetheless, many of the risk-weights within the proposed regulation continue to warrant further evaluation. The NCUA ignores the uniqueness of credit unions and how credit unions handled the effects of the recent economic downturns to its members. Credit unions are known for promoting and conducting responsible lending and managing its financial statements. The diversification and growth opportunities provided by the cooperative nature of credit unions provide a sustainable future the industry and members of credit unions.

The Proposed Rule is inconsistent with Congress' direction that "design of the risk-based net worth requirement should reflect a reasoned judgment about the actual risks involved."[6] The following outlines risk-weight concerns under the Proposed Rule that require additional attention and reevaluation.

- **Real Estate Loans**

  The Proposed Rule risk-weights the entire real estate portfolio with consideration of concentration risk of the portfolio to total assets of the credit union. The Proposed Rule does not consider the types of real estate loans within a credit union's portfolio. For example, a credit union's real estate portfolio's adjustable rate loans and/or shorter term loans, such as 10-year fixed rate loans, have far less risks than the portfolios' 30-year fixed rate loans. The Call Report currently has information disclosed at some level of detail for a credit union's real estate portfolio. Therefore, the NCUA should further segment a credit union's real estate portfolio to then risk-weight the varying risks within a credit union's real estate portfolio.

- **Credit Union Service Organizations (CUSO)**

  The Proposed Rule risk-weights an unconsolidated investment in CUSO at 150%. The comparison of such a credit union investment to Other Agencies investments is not justifiable. I recommend a maximum 100% risk weight to an investment in CUSO is recommended. This would be consistent with the risk weight assigned to loans to CUSOs.

- **Mortgage Servicing Assets (MSA)**

  The revised Proposed Rule did not change MSA's risk weight of 250%. The NCUA should decrease the risk-weight of such an asset as such a high weight does not accurately reflect the risk to capital of a credit union. Additionally, the NCUA should consider the two alternative methods of carrying MSA under generally accepted accounting principles. A credit union is allowed to account for MSA at fair value or at the lower of cost or market. Using either methodology, the maximum value would be reflected as the market value. In either situation, any reduction in market value or impairment would be reflected as an earnings adjustment, to reflect any deterioration in value.

- **Treatment of Mutual Fund Investments**

[6] S. Rep. No. 193, 105th Cong., 2d Sess. 13 (1998) (S. Rep.)

The “full look-through” approach described in the Proposed Rule fails to apply risk-weights to mutual fund investments in a consistent manner to the holding of the same securities by credit unions directly. For instance, a credit union that holds “U.S. Treasuries and Government Securities” would assign a risk-weight of 0% to such holdings. In contrast, an investment fund, with similar U.S. Treasuries and Government Securities, would have a risk-weight of 20% assigned to this asset. This disparity in the treatment of the same asset when held by two different entities unnecessarily discriminates against a credit union’s investments in mutual funds by penalizing the credit union for making the same investment indirectly that they could otherwise make directly. Further, the added layer of risk that the Proposed Rule assumes will be present for indirect investments is not a factor with mutual funds. Mutual funds provide daily redemption at net asset value and generally provide sold share proceeds to the investor on the next business day.

The NCUA should revise the RBC regulation so that mutual fund risk-weights are consistent with the risk-weights on the underlying instruments. We suggest a full look-through approach that is attuned to the distinctions between underlying assets that would allow low-risk mutual funds to carry risk ratios ranging between the 0% and 20% based upon the actual risk ratio of their holdings.

We also suggest that the Proposed Rule be clarified to indicate the timing of “the most recently available holdings reports” that are to be used by credit unions employing the full look-through approach for their analysis of investment fund assets.

- **NCUSIF Deposit**

  The credit union system has capitalized its own separate, federal insurance fund, years ago. This structure and its current value should not be overlooked. The 1% deposit made by all federally-insured credit unions to the NCUSIF is an asset which should be properly included in any risk-based capital calculation. This amount is fully refundable should a credit union convert to private insurance (where allowed), or convert its structure to a bank. This balance is considered an asset in accordance with Generally Accepted Accounting Standards. The NCUSIF deposit should be included in the RBC calculation.

A Separate Interest Rate Risk Rule

It is appreciated that the Board removed the portion of the regulation associated with the interest rate risk component. The current Supervision and Examination process is a more adequate way to address concerns with a small group of potential outliers. Adding additional regulatory burden to credit unions strictly based on asset size is not necessary.

Should the Board decide to issue a proposal in the future, similar to the process utilized for the derivative rule, the issuance of an Advance Notice of Proposed Rulemaking is encouraged. This will enable the Board to receive constructive feedback, prior to deciding on issuing a proposal.

Other Supplemental Forms of Capital

The NCUA's efforts are strongly supported and urged to extend this work to incorporate supplemental capital for all credit unions. The need for capital modernization continues as credit unions experience the challenges with no alternatives for growth opportunities beyond their ability to generate retained earnings. Credit unions seek supplemental capital as a tool to increase loan portfolios and other growth opportunities for its cooperative plans and goals. If the Proposed Rule is finalized, it should include the supplemental capital within its framework.

Thank you for taking the time to review my comments.

Sincerely,

Mary Ryan
Account Services Center Manager
Digital Federal Credit Union