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April 27, 2015

Filed via regcomments@ncua.gov
Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Comment to the Second Proposed Prompt Corrective Action – Risk-Based Capital Regulation

Dear Mr. Poliquin:

As the nation's leading credit union service organization (CUSO), PSCU is pleased to comment on the proposed Risk-Based Capital Regulation (RBC2). For context, we are owned by nearly 800 member credit unions nationwide. PSCU delivers service, technology, product and pricing advantages they cannot achieve individually. For us and our members, we believe the CUSO model works, and that is why we feel strongly that any regulation which impedes investments in CUSOs is dangerous to our industry and our members.

RBC2 represents an improvement in many respects, but it remains fundamentally and fatally flawed. It is overly complex, not based on any actual empirical risk or loss data presented by NCUA, and is inconsistent with The Federal Credit Union Act. NCUA continues to present anecdotal and unsubstantiated references to what it considers "substantial" CUSO "losses" over the last decade as justification for an excessive risk weight to CUSO investments. No detailed statistics have been provided to justify any losses as substantial. We urge NCUA to withdraw the proposal and, in lieu of that, we strongly encourage NCUA to make substantial improvements to the proposal consistent with our comments herein and other industry comment letters submitted to NCUA.

In its current form, the proposed RBC2 stands to damage the health of credit unions rather than protect them. In fact, we believe one of the key flaws is that it will ultimately discourage investment in CUSOs. We're counting on NCUA to prevent that from happening. As the governing body that regulates and protects the interests of credit unions, please consider the following recommendations to the proposed rule:

• **CUSO Investment Risk Rating:** The weighting of 150% will discourage CUSO investment and therefore undermine a strong underpinning of credit union health. **PSCU recommends that NCUA remove risk weighting above 100% for CUSO investments.**

• **Appreciation of CUSO Investment:** The weighting of CUSO investments based on current GAAP value instead of initial invested value will discourage investment in successful CUSOs. **PSCU recommends that NCUA base the investment value in a CUSO on the initial credit union investment, not the current GAAP value of that investment.**

The true risk to the credit union industry is not the investments or loans to CUSOs; in fact, it is actually the opposite. The risk is not investing in CUSOs to share risk, reduce costs and increase income. PSCU is providing strength in numbers, and with these adjustments to the proposed rule, we can continue to do so for years to come.

CUSO Investment Risk Rating:

We understand that the CUSO investment risk rating was calculated from an attempt to incorporate an approach similar to how BASEL III risk rates bank equity investments. If that is the case, this approach is flawed in its basic assumptions because banks have the power to make investments in a number of types of organizations and the value to the bank is measured in the ability to receive income through dividends or upon an equity sale. These bank investments are not made in companies like CUSOs that are serving as collaborative cost sharing platforms. CUSO investments, on the other hand, are often based on cost sharing alone, and many credit unions benefit greatly by CUSOs that never make any distributions. Unlike the banking investment powers, the CUSO risk exposure is limited to an immaterial level. The 17 basis points of credit union assets invested in CUSOs industry-wide is also less than the annual corporate assessments. Each federal credit union may only invest a maximum of 1% of assets in CUSOs. Credit unions could lose all their CUSO investments and the loss would not be material. What would be material is the elimination of the cost sharing and innovation that so many credit unions enjoy. NCUA would be making a huge mistake by not recognizing the adverse policy implications of applying the BASEL bank investment risk ratings to CUSO investments.

Further, if we follow a bank-based investment risk approach, we see that the FDIC defines non-significant investment exposures in unconsolidated equity of a privately held company as an aggregate of 10% or less of a bank's capital (which is then risk weighted at 100%). Given that 97.7% 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%.

We particularly disagree with the 150% risk weighting since, in its Letter to Credit Unions No. 13-CU-13, NCUA stated that the new CUSO Rule was necessary because NCUA does not have "accurate information" on CUSOs. Risk weighting an asset at greater than 100% should only be based on data that such asset has an objectively higher level of risk – such higher risk is the reason for the higher weighting. Because NCUA itself has asserted that it does not have accurate information about CUSOs, NCUA cannot have sufficient basis to risk weight CUSOs above 100%; therefore, CUSOs should only be risk rated at 100%. Once NCUA begins receiving information from CUSOs and has an opportunity to evaluate that information, then NCUA will have sufficient information to evaluate the risk weight for CUSO investments.

Additionally, we object to the CUSO investment risk rating being disproportional when compared to other risk ratings. For example, delinquent first lien mortgage debt is risk rated at 100%. Yet investments in CUSOs that have added millions to the bottom line in the form of both earnings and savings to credit unions over the past decades are somehow deemed riskier, with a 150% risk rating. Given the significant credit union losses on mortgages in the recent financial crises, it is untenable to weight CUSO investments with a substantially higher risk. We have not seen any evidence to support NCUA's position that CUSO investments are much more risky than delinquent first lien mortgage debts. Without hard evidence, these percentages are arbitrary and unsupported.

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CUSO investments and loans are already strictly controlled, due to the already established CUSO investment and loan regulatory limits in place. Moreover, the only justification for higher than a 100% risk weight would be to capture the riskiest outliers. We believe that arbitrary regulation focused on the outliers of the industry is unreasonable and certainly not in the spirit of reducing regulatory burdens on credit unions. The outliers can and should be addressed through the supervisory examination process. We respectfully suggest that the credit union supervisory process is the appropriate mechanism for addressing any credit unions where the NCUA believes that the CUSO investment of the credit union creates excessive risk to a credit union.

Further, the NCUA Board recently passed the final CUSO Rule, which dramatically increases NCUA's ability to regulate the investments and loans a credit union makes to a CUSO. This enhanced authority and oversight support a lower risk-weight.

NCUA has repeatedly been asked for evidence of "significant" CUSO losses to the NCUSIF to no avail. NCUA broadly references some losses in the final CUSO Rule, all of which were related to lending risk where the credit union losses had nothing to do with CUSO investments and were instead simply poor decisions on lending risks. This is operational risk, not investment risk.

But RBC2 fails to address operational risk with respect to credit union vendors. Third party vendor authority is not relevant to RBC2. If NCUA is concerned about its lack of third party vendor enforcement authority as part of the justification for the risk weights assigned to CUSO investments, we can only presume that the risk weight is partially – if not totally - based on operational risk. As NCUA notes, CUSOs are in their view similar to third party vendors. However, we cannot find any references in the proposal that would account for the alleged risk posed by non-CUSO third party vendors. Only CUSOs are singled out for their supposed risk. Surely, this cannot be the justification for the risk weight assigned to a CUSO investment.

Another reason to change the risk weighting to 100% is that oversight, due diligence and risk management of CUSOs is already prescribed via the NCUA's Vendor Due Diligence regulations. Credit unions must actively manage all of their vendors including CUSOs, which can be an effective tool to minimize risk. Accordingly, an additional RBC requirement to single out CUSO risk is not necessary.

A final concern is the one-size-fits-all nature of the 150% risk weighting. All CUSOs are not alike. CUSOs like PSCU serve hundreds of credit unions and generate millions of dollars a year of net income for those credit unions, while other CUSOs are much smaller and may solely be used for operational services. It does not make sense that, for example, an investment in a CUSO engaged in low-risk activities like providing compliance assistance would be assigned the same risk-weight as an investment in a CUSO engaged in commercial loan underwriting. 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. The CUSO investment risk analysis does not factor in: (a) the materiality and timing of the amount(s) invested, (b) whether dollars are actually invested or the investment amount is solely based on profits, (c) whether the investment represents operational costs that would be otherwise incurred by the credit union, (d) whether the investment amount has been fully recovered by the credit union through cost savings or additional income, (e) whether the CUSO has a history of profitability, or (f) the types of services that are being provided. If the NCUA rejects the arguments as to why all CUSO investments should be rated at 100%, then we strongly suggest that a well-reasoned, formulaic approach that rates certain CUSOs at 100% and others at 150% is preferable to a single 150% risk weighting for all CUSOs.

Our industry loses 3% of our credit unions every year due to factors such as competitive pressures, the need for increased technology investments, and regulatory burden; that rate could increase significantly if the full impact of the new regulatory compliance onslaught overwhelms credit unions. At the very time that CUSOs are needed to help sustain credit unions, we are greatly concerned that NCUA is creating a regulation that will be a disincentive for investments in CUSOs.

Appreciation of CUSO Investment:

Another deficit of the CUSO risk-weight proposal is that the 150% risk weight is based upon current GAAP value of the CUSO investment, rather than the initial investment, thus penalizing growth (or success) in investment value. We understand that NCUA intends to apply the CUSO capital risk rating to both the investment made by the credit union and the appreciated value in the CUSO. PSCU has been fortunate that we have been able to pay millions in dividends to our member owners, while at the same time enabling them to build millions in allocated equity in PSCU. Applying the CUSO capital risk rating to both the investment made by the credit union and the appreciated value in the CUSO would have the net effect of NCUA penalizing the success of a CUSO by requiring the credit union to reach into its pocket and set aside additional capital on the profits earned by the CUSO. We strongly believe credit unions should only account for their cash investment in a CUSO and not the appreciation of that investment over time. This approach will incentivize good investment behavior and promote collaboration as a valuable tool for the credit union industry.

Summary:

There is certainly a danger to credit unions not having enough capital to cover the risks credit unions pose to the share insurance fund. However, there is also a danger to the sustainability of credit unions if an unnecessary amount of capital must be reserved in proportion to an individual credit union's balance sheet risk. If credit unions are required to reserve an excessive amount of capital, then surely member services, net income opportunities, and credit union growth will suffer. We believe that RBC2 will lead to these results and we urge NCUA to withdraw it.

If withdrawing RBC2 is not an option, we suggest that NCUA make significant changes including bringing the CUSO investment risk-weight in line with the 100% risk weight for loans to CUSOs as well as non-significant investments in unconsolidated equity for banks, and only applying the CUSO investment risk weight to the original amount invested in the CUSO. This would be much more consistent with the inherent risk of the investment and serve not to penalize successful CUSOs.

Thank you for the opportunity to comment.

Sincerely,

Steven A. Salzer,
SVP, Legal and General Counsel