GREATER NEVADA Credit Union

April 27, 2015

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

Subject: Comments on Revised Prompt Corrective Action/Risk-Based Capital Proposal

Dear Mr. Poliquin:

I am Wally Murray, President/Chief Executive Officer of Greater Nevada Credit Union (GNCU) and current Chair of the Nevada Credit Union League. GNCU is the largest credit union based in northern Nevada and has been in existence since 1949. I have been employed by this credit union for over 26 years and have served in my current capacity for the last 14. Our growing, well capitalized credit union serves over 47,000 members, has assets in excess of $515 million, is state chartered and federally insured.

I am also a member of NCUA's Industry Panel that was assembled to provide input on this proposal and also serve on CUNA's Subcommittee on Examinations and Supervision. In addition, in February of this year, I was honored to provide testimony to the United States Senate Committee on Banking, Housing and Urban Affairs on the topic of Regulatory Relief for Community Banks and Credit Unions.

My purpose today is to comment on NCUA's latest proposed amendments to the regulations related to the current system of Prompt Corrective Action (PCA) and Risk-Based Capital (RBC). The views and opinions expressed in this letter are my own and should not be considered to be reflective of any other individual or body.

An Ill-Conceived Proposal

As I stated in my comment on the initial proposal, I hereby respectfully request that the NCUA Board immediately and permanently withdraw this proposed regulatory amendment. Such a request is not made lightly, nor out of some imprudent position that all new regulation should be avoided. Rather, it comes from the position that this particular proposal is both unnecessary and ill-conceived. Evidence for this position stems from the following facts:

- During the severe economic downturn of a few years ago, the current credit union capital model and PCA framework went through the most trying test it has ever faced. Yet it stood up extremely well. The nadir for the collective net worth ratio of all federally insured credit unions during that period was 9.67% in March 2009. Viewed another way, this means that the industry as a whole still had $22.9 billion in combined capital above and beyond the regulatory level deemed to be well capitalized at its lowest point during one of this nation's worst economic crises.

One of NCUA's stated goals in seeking to establish a new system is articulated in the following statement from the original proposal: "The proposed risk-based capital ratio is designed to enhance sound capital management and help ensure that credit unions maintain adequate levels of loss-absorbing capital going forward, strengthening the stability of the credit union system and ensuring credit unions serve as a source of credit in times of stress."[1] Given that the existing capital model within credit unions has already clearly demonstrated the type of stability and resiliency desired by the agency during one the most financially stressful period in three quarters of a century, it is clear that there is no need for a new system for the industry.

- To this point in time, no federal governmental entity, including NCUA and the Treasury Department, has ever publicly stated <u>what level of losses the NCUSIF should have reasonably expected to sustain during an economic downturn of the magnitude experienced in the last decade</u>. Therefore, there has been no ability for the credit union industry or any other interested parties to determine whether the insurance losses that actually occurred were excessive, which would be an indicator of a potential need to enhance the existing capital system.

  That flaw alone shows that no foundation exists to justify imposing a new system whose purpose is to encourage credit unions to build more capital.

- The proposal is modeled on concepts derived from the Basel III framework. That framework was designed to address capital issues in the global banking industry, not the U.S. credit union movement, which has an entirely different capital model.[2] In fact, experience now shows that the credit union capital model served its purposes far better than did the banking capital model during the crisis.

  And rather than justifying the proposal by properly focusing on the specific impact to U.S. credit unions, which is the industry that NCUA regulates, the agency instead relies on an esoteric statement from the Basel Committee relative to international trends that indicates *"…a review of the historical record over a range of countries and recent time periods has suggested that a significant crisis involving depository institutions occurs about once every 20 to 25 years, and has a typical cumulative discounted cost in terms of lost aggregate output relative to the precrisis trend of about 60 percent of precrisis annual output."*[3] In essence, the agency is positing that a major reason why this regulation is needed is because once every generation there is a situation somewhere in the world that involves depository institutions that causes them to incur significant losses. That is extraordinarily weak support for imposing a new system that greatly increases the regulatory burden on the American credit union industry, and only serves to give credence to those that criticize this proposal as "a solution in search of a problem."

  Setting aside preposterous rationalization attempts using international anecdotes, credit unions already have a more onerous capital burden than their U.S. banking counterparts, with leverage ratios that are generally 100-200 basis points higher. And, using any barometer, the comparative data between the performance of credit unions and banks during the economic crisis clearly shows that credit unions were superiorly positioned when that period commenced

[1] NCUA proposed rule on Prompt Corrective Action--Risk-Based Capital, pg. 41
[2] It must also be noted that the Basel III framework remains both not fully implemented and not tested under pressures like those of the recent economic crisis. Therefore, its reliability to perform adequately is questionable at best.
[3] NCUA proposed rule on Risk Based Capital, January 27, 2015, pg. 16.

and functioned far better throughout its duration. Examples of that material performance disparity of credit unions over banks include:

- Over 70% fewer total credit union failures than bank failures during that timeframe
- Credit unions maintained far healthier deposit/share insurance fund ratios, as evidenced by the fact that the FDIC fund was actually bankrupt for two consecutive years during the crisis while the NCUSIF remained above $1.20 per $100 in insured shares the entire time.
- Lower insurance fund losses caused by credit unions by more than 90% over the period
- There was no need for credit unions to rely on a program like the Troubled Asset Relief Program (TARP) that invested over $400 billion of governmental funds to prop up failing banks and induce them to begin lending again.[4]
- Credit union loan loss ratios that were less than half as high as banks during the peak of the crisis and remain lower still today.

Given this set of facts, not only should there be no rush by NCUA to mimic the banking capital model, agency officials should instead be simultaneously praising and vigorously defending the existing credit union model both publicly and privately due to its inherent strength and demonstrated ability to withstand immense economic pressures.

- The comment letters on the original proposal submitted by the former Speaker of the United States House of Representatives, the Honorable Newt Gingrich, and the former Chair of the Banking Committee of the United States Senate, the Honorable Alphonse D'Amato, unequivocally demonstrate that this proposal takes the concept of PCA well beyond the bounds intended by those elected officials who imposed it on credit unions a little over 15 years ago. To reiterate their positions, PCA for credit unions is different than PCA for banks by the intentional design of lawmakers, and it is inappropriate for a regulatory body to now seek to institute a more restrictive system. In addition, it was never the intent of Congress to impose a risk based capital standard to determine whether a credit union is well capitalized; instead, the Federal Credit Union Act clearly states that those standards were to be used solely to help determine whether a credit union was adequately capitalized. Therefore, this proposal exceeds the intent of the original mandate set forth by Congress and the President, and the actual law.

  In the period between the first and second versions of this proposal, NCUA Board member Mark McWatters has also strongly stated on multiple his agreement that this proposal exceeds NCUA's legal authority. The agency attempted to provide support to its position by obtaining a third party legal review, at an extremely high cost, which only indicated that there was a modest chance that the agency would prevail if a legal challenge were ultimately mounted.

As the above information clearly indicates, the rationale supporting the need for this proposed regulation is extremely dubious and a solid need has not been demonstrated. Therefore, it should be withdrawn.

[4] In fact, this action by the executive and congressional branches actually added to the competitive pressures that natural person credit unions had to withstand during the economic meltdown, since the implementation of the TARP program meant that they were also effectively competing against the U.S. government while attempting to survive the crisis. Yet they still managed to significantly outperform their banking counterparts.

Encouraged by Improvements, But Proposal Still Unnecessary

I acknowledge that the agency made substantive improvements to the initial proposal, and appreciate the opportunity to have been involved in helping provide the perspective of practitioners in that process. Along with many in the industry, I specifically recognize and appreciate the following improvements:

- The reduction in the scope by increasing the asset threshold for complex credit unions to $100 million.
- Reducing the risk based capital (RBC) requirement for well-capitalized credit unions from 10.5% to 10.0%, even though such a separate RBC level was never intended and remains potentially impermissible under the statute.
- The common sense refinement of many of the risk weights.
- Sensibly refining the definition of commercial loans for RBC purposes, including removing governmental guarantees on such loans, to differentiate them member business loans and the regulatory language associated with that category.
- Redefining current loans as being those that are 90 days or less past due, rather than 60 days or less.
- The removal of interest rate risk from the proposal.
- Allowing the entire Allowance for Loan and Lease Losses account to be included in RBC.
- Eliminating the provision on individual minimum capital.
- Permitting some forms of goodwill to be included in RBC for a period of time.
- Delaying compliance until 2019.

However, despite the increased level of engagement and the resulting improvements that have been made, they are not enough to overcome the fact that the entire proposal remains unnecessary. Therefore, the proposal should be withdrawn in its entirety.

Small, but Substantially Harmful, Remaining Flaws with Respect to Net Worth Restoration Plans (NWRPs) and Business Plans for New Credit Unions

Pertinent Background

The information below relative to our credit union and its performance during the economic crisis is a bit lengthy, but necessary to substantiate my points regarding the topic of NWRPs.

Since our credit union conducts its business in a state that experienced the full impact of the economic crisis of the last decade, and yet found a way to survive in light of those dire circumstances and thrive on the other side of them, I have some relevant perspectives to share regarding the potential impacts of this proposal that discusses what levels of capital are deemed appropriate and the potential implications for not amassing enough.

History has now clearly demonstrated that GNCU was ready for those trials as a result of having operated in a safe and sound manner throughout the history of the credit union, and we were able to successfully navigate through those challenges. One of the ways this was accomplished was through a history of prudent capital management. Although the PCA framework established in the late 1990’s stated that the net worth ratio level to be well capitalized was 7.00%, for many years our Board and management team consciously recognized that was not high enough for the risk profile of our credit union. We understood the operations of GNCU had other inherent risks that needed to be accounted for in our capital model. Those included the fact that we were geographically limited to serving only consumers in northern Nevada, that we were growing fairly rapidly, and that we were involved in some lines of business, such as indirect vehicle and real estate lending, which carried somewhat elevated risk levels by their very nature. Therefore, we had long established an internal minimum acceptable net worth ratio for GNCU of 8.50%, which is more than 21% higher than the well capitalized level defined by NCUA regulation. By the time the first wave of the economic calamity began to manifest itself in late 2007, the net worth ratio of our credit union been increased to 9.25%.

As we worked through the challenges from the economic crisis, it was no surprise to see GNCU's capital position weaken. After all, the primary purpose of capital is to provide protection in the event of a financial downturn for the company, and for the first time in many years it was being called upon to deliver on that promise for our institution. While it fell at an alarming level, dropping to a low level of 5.09% in mid-2010 that required compliance with PCA, the defense mechanisms that the Board and management had built into our internal operations were clearly working in conjunction with the plans we were executing to bring about a rebound.

From a business perspective, the situation dictated that we scale back our operations significantly, reduce member benefits and service offerings, and become more conservative in our decision making. Each of those areas was addressed in the Net Worth Restoration Plan (NWRP) that we were ultimately able to get approved.

THE POINT: My comment letter on the original proposal included each of the two bullet points below. While it was encouraging to see NCUA's revised proposal address so many of the comments it received during the original commentary period, <u>these two specific comments appear to have been completely ignored</u>.

- The proposal to make a de facto determination that it would be considered an unsafe and unsound practice for any credit union to submit more than two NWRPs that are not approved is unsubstantiated, capricious, and incredibly misguided. It also entirely ignores due process in making a unilateral declaration that substantially impacts a credit union's capability to conduct its business as usual. Therefore, it should be withdrawn.

  The only support provided for this proposed change within the proposal is, *"NCUA regional directors have expressed concerns that some credit unions have in the past submitted multiple NWRPs that could not be approved due to non-compliance with the requirements of the current rule, resulting in delayed implementation of actions to improve the credit union's net worth."*[5] Basing such a change solely on a single anecdotal statement is a highly questionable methodology for determining regulations for an industry, and can have extremely damaging and unwarranted consequences for individual credit unions.

[5] Ibid., pg. 333. (This same statement was included in NCUA's original PCA/RBC proposal from 2014 on pgs. 92-93.)

As the background information on our credit union indicates, during the peak of the economic crisis our credit union's capital fell to a level that required us to comply with PCA and submit an NWRP to the agency. That was a professionally scary period for our credit union and one of our greatest fears was NCUA. Therefore, we approached the NWRP submission process with extreme caution and trepidation, which led to crafting an initial NWRP that we thought was quite conservative while still being relatively realistic.

As a former CPA and longtime CFO of this credit union before I was promoted to my current position, I personally worked diligently on that plan to ensure that all of the numbers made sense and flowed appropriately across each quarter being projected. Nevertheless, attempting to decipher the obtuse regulations governing PCA, while simultaneously trying to factor in the confusing manner in which we were expected to address Troubled Debt Restructures (TDR) at the time made drafting that plan a tremendous challenge. Adding to that challenge was the fact that the sole resource assisting our credit union in the endeavor to put together our plan was a supervisory examiner who was already freely expressing serious concerns about our ability to survive through that difficult period. Beyond that, the agency offered no resources relative to drafting a successful NWRP in terms of templates or training.

Those factors resulted in our NWRP approval process ultimately lasted exactly six months, and <u>the plan was not approved until our fourth attempt</u>.[6] The main issue in our multiple submissions centered on the treatment of delinquencies, TDRs, charge offs and the resulting provision for loan losses. Therefore, each NWRP version we submitted became more and more conservative, to the point where we knew internally that they no longer reflected reality. Nevertheless, we needed to get an NWRP approved.

Interestingly enough, as we emerged from our difficult financial situation and were ultimately came out of PCA, we noticed that the version of the NWRP that our performance through that time most closely mirrored was...*the first version that we had submitted*. And yet, had this proposed regulation been in place at the time, <u>it would have meant that we would have been guilty of committing an "unsafe and unsound practice!"</u>

That is why it would be blatantly inappropriate to now impose a rule that unilaterally declares that a credit union has committed an unsafe and unsound practice and is subject to administrative sanctions simply because it failed in several good faith efforts to get an NWRP approved. Absent the context and mindset surrounding such a situation, including the fact that being under a requirement to submit an NWRP is a scenario that no credit union can ever realistically be expected to prepare for, is leading to faulty rulemaking in a highly sensitive area.

While we may have consumed agency resources during that harrowing six month period to get our NWRP approved that were deemed to be excessive, I would readily do it all over again tomorrow if that's what it took to help our credit union survive. So it's not clear to me how that could ever be considered an unsafe and unsound practice.

[6] It must also be noted that we were not just sitting idly by while this NWRP approval process was ongoing. Instead, we were working diligently to improve our capital position. We did not need an approved NWRP to tell us it was critically important to do so.

- For similar reasoning, the unilateral categorization that a newly chartered credit union that files more than two unapproved business plans is equally illogical and can only serve to discourage such new charters. A new credit union would rarely have an asset base that represents any substantive risk to the NCUSIF, and those people trying to get them off the ground will already be dealing with a litany of regulatory hurdles. What possible good does it do to add something like this to their list of concerns at a time when appropriate public policy would be to seek ways to encourage them to succeed?

  As such, this portion of the proposal also needs to be withdrawn in its entirety.

Conclusion

Once again, while the latest proposal offers significant improvements over the first version, no true case exists for the imposition of any new rule with respect to Risk Based Capital or Prompt Corrective Action. Therefore, the NCUA Board should withdraw this needless proposal.

Thank you for the opportunity to comment.

Sincerely,

Wallace Murray
President/CEO
Greater Nevada Credit Union