April 27, 2015

Mr. Gerard Poliquin
Secretary of the NCUA Board
1775 Duke Street
Alexandria, VA 22314

**RE: Comments on Proposed Rule: PCA – Risk-Based Capital**

Dear Mr. Poliquin:

Boeing Employees' Credit Union ("BECU") is pleased to comment on the National Credit Union Administration's ("NCUA") proposal on *PCA – Risk-Based Capital* published in the Federal Register on January 27, 2015.

**Introduction and Background**

As the nation's fourth largest credit union, with a current membership of 886,677[1], this proposal, as adopted, will have a profound impact not only on the nation's credit unions, but their membership base as well. Put simply, credit unions will be competitively disadvantaged from those institutions that are not subject to NCUA's regulations. BECU alone has nearly one million members who could be negatively impacted by NCUA's proposal. NCUA's implementation of a risk-based capital regime may very likely impact BECU's future growth and in essence impact service to its members and future members.

The sheer impact of NCUA's proposal makes it one of the most significant rulemakings that NCUA has proposed in recent history and because of that fact, BECU and over 2,000 credit unions provided comments on NCUA's initial proposal published in January 2014. As a result of the sheer volume of comments received, Congressional inquiry, and the importance of this issue, NCUA has redrafted the rule and created a new comment period, as required by the Administrative Procedures Act.

BECU is pleased that NCUA has listened to credit unions during the first round of comments, and is encouraged that NCUA will reconvene the working group of credit union practitioners who are looking at risk-based capital from a universal perspective. We are also pleased that NCUA has modified this new rule by removing the following from the original proposal: an individual capital requirement, interest rate risk, revising a number of risk weights, and providing a longer implementation period to name a few. BECU views all of these revisions as positive signs toward capital reform.

Despite NCUA's modifications to the original proposal, BECU strongly believes that a new risk-based capital rule is not necessary and we will continue to raise our objections. NCUA's revised proposal does not adequately establish a truly complete capital regime for credit unions. We

[1] Data derived from 12/31/2014 Call Report.

believe that achieving a fair and comprehensive system of capital for credit unions will require changes to the Federal Credit Union Act. In short, Congress must act.

Due to the volume and complexity of issues identified in this proposal, BECU will provide two separate comment letters addressing its scope. This comment letter will focus on the differences between the first and second proposals and BECU's continued concerns. The second comment letter will address, exclusively, the treatment (or lack thereof except in very limited circumstances) of supplemental capital under a risk-based capital framework.

**Legal Authority**

This proposal introduces a new scaled risk-based capital measurement approach for assigning capital classifications for well capitalized, adequately capitalized, and undercapitalized credit unions. Most notably, for a complex credit union to be deemed "well capitalized," its risk-based capital ratio must exceed 10 percent (reduced from 10.5 percent in the original proposal). To be deemed "adequately capitalized," a complex credit union's risk-based capital ratio must exceed eight percent. As a result, under the proposal, a credit union that is otherwise "well capitalized" based on its net worth ratio, could lose that designation if its risk-based capital ratio falls between eight and nine point nine nine percent (8-9.99%), in which case it would be deemed "adequately capitalized."

It is BECU's belief that NCUA lacks the statutory authority to prescribe a separate risk-based capital threshold for "well capitalized" and "adequately capitalized" credit unions. The Federal Credit Union Act expressly provides that NCUA shall implement a risk-based net worth requirement that "take[s] account of any material risk against which the net worth ratio required for an insured credit union to be *adequately capitalized* may not provide adequate protection." The Federal Credit Union Act does not provide NCUA the express authority to implement a separate risk-based net worth threshold for the "well capitalized" net worth category. Simply put, Congress has not expressly authorized the Board to adopt a two-tier risk-based net worth standard.

Even NCUA Board Member J. Mark McWatters, the dissenting vote on the proposal, called NCUA's lack of legal authority the most "fundamental issue presented before the Board" and offered a lengthy and exhaustive statement to that end.

**Proposal is Not Competitively Neutral**

In addition to BECU's belief that NCUA lacks the legal authority to impose a two-tiered capital system based on a credit union's leverage *and* risk, we think that such a two-tiered system has the practical effect of placing the credit union industry at a competitive disadvantage. For example, under this second proposal, NCUA reduced credit unions' risk-based capital ratio from 10.5 percent to 10 percent in order to be classified as "well-capitalized." NCUA indicates that reducing the risk-based capital ratio to 10 percent places credit unions on par with the FDIC's rules which are currently at 10 percent (taking into account the 2.5 percent capital conservation buffer) in order to receive a well-capitalized designation.

However, NCUA neglects to address the critical fact that banks have the ability to raise supplemental capital by issuing stocks and therefore, have more flexibility in meeting the 10 percent risk-based ratio. Credit unions are prohibited from raising supplemental capital. Until Congress passes legislation allowing credit unions to raise supplemental capital, BECU requests that NCUA abandon its two-tiered approach in setting the capital ratio requirements. If NCUA does not agree, it will be in the dubious position of creating a rule that is not on par with the other banking agencies.

**Supervisory Assessment of Capital Adequacy**

BECU applauds NCUA's elimination of the individual minimum capital requirements ("IMCR"). We believe the vast number of credit union concerns about this requirement played a role in its removal. The original proposal regarding this subject provided NCUA with complete discretion, unchecked by a requirement for consultation with the State Supervisory authority in the case of a state-chartered credit union, to demand higher capital levels from any credit union at any time. BECU believes that agency discretion should be controlled by clear standards, delineated administrative processes, and a robust appeals process, all of which were lacking in the original proposal.

BECU appreciates that NCUA eliminated this requirement, but we remain concerned with the language in this new proposal. At the outset, BECU wishes to express its general support of NCUA's policy that credit unions should maintain capital in a manner that addresses their risk exposure. However, this proposal adds a requirement that a complex credit union must maintain capital commensurate with the level and nature of all its risks. The proposal also requires a credit union to create a process to determine its capital adequacy in light of its risk and a comprehensive *written* strategy to maintain "an appropriate level of capital."

The Federal Credit Union Act does not grant NCUA the authority to impose IMCR or a de facto IMCR. 12 U.S.C. § 1790d(d). Congress authorized specific circumstances under which a credit union could be "reclassif[ied]" and subjected to more stringent capital standards, but did not legislate a provision allowing NCUA to prescribe IMCRs for particular credit unions. The corresponding FDIC provision is 12 CFR 324.10(d), which derives its statutory authority from 12 USC 3907, and that provision only applies to "appropriate federal banking agencies" as defined in 12 USC 1813(q) (i.e. not NCUA).

Specifically, this proposal, like the first proposal, invites examiners to second guess a credit union's capital strategies and balancing of risks. NCUA examiners currently have the tools they need to make this assessment, and a separate written capital plan is an unnecessary prescriptive regulatory burden especially for those large credit unions that are already subject to distinct capital planning requirements under 12 C.F.R. Part 702. BECU fears that examiners will have too much discretion to drive credit union capital planning.

NCUA indicated that its assessment may include a review of the level and severity of problem assets and a credit union's exposure to operational risk, interest rate risk, and significant asset concentrations. BECU, like most credit unions, is already subject to numerous regulatory requirements impacting capital adequacy. By way of example, BECU is required to create and update written policies on interest rate risk management, liquidity (in conjunction with a contingency funding plan), net worth and capital accounts as well as a written capital plan that NCUA must approve. Therefore, we are perplexed as to why NCUA feels compelled to create this additional and duplicative requirement.

In addition to evaluating the appropriateness of a credit union's capital plan (which NCUA currently reviews under 12 C.F.R. Part 702.501-506 for credit unions of a certain asset size), NCUA's supervisory assessment will also take into account the quality and trends in a credit union's capital composition and whether the credit union is entering new activities or introducing new products. For BECU, as a covered credit union subject to the requirements under the newly established capital planning rules, NCUA's further review for purposes of risk-based capital, appears to be an unnecessary duplication of effort.

NCUA's unilateral assessment of capital adequacy, outside of the parameters of the existing capital planning rule, go beyond what is required in a final risk-based capital rule. The effect subjects credit unions to uncertainty. Credit unions will never be confident that their capital strategies are adequate and will be left in a state of flux about their decision making abilities.

Additionally, as mentioned above, large credit unions such as BECU are already subject to NCUA's capital planning and stress testing requirements, which cover essentially the same matters in this proposal. Therefore, NCUA's insertion of separate capital adequacy requirements under this proposal is unnecessary, duplicative, and burdensome. As a result, BECU requests that NCUA do any of the following: (1) remove this provision entirely; (2) remove the written element; or (3) exempt those credit unions such as BECU that are already subject to the capital planning and stress testing rule.

## Risk Weights

Under this proposal, NCUA made significant changes to the risk-weighted assets (the denominator of the risk-based capital ratio calculation) from the original proposal. BECU is encouraged by most of the changes because they are in parity with the Federal Deposit Insurance Company ("FDIC") risk weights in those instances where parity between the two acts makes sense.

NCUA's inclusion of concentration risk in the risk weights is not comparable to the other banking agencies' PCA requirements. We do not understand NCUA's justification for such higher risk weights in light of the fact that credit unions weathered the financial crisis far better than banks. If NCUA is concerned about outlier credit unions, it has the supervisory tools to address individual credit unions' concentration risk. For instance, NCUA can apply the capital adequacy planning requirements of 12 C.F.R. Section 702.101(b) to those outlier credit unions.

*a) Risk-Weighted Examples*

BECU is concerned that the following (identified below) have higher risk weights than what the FDIC proposes for banks and thus places credit unions at a competitive disadvantage. For example:

- first lien residential real estate loans over 35 percent of assets would have higher risk weights than banks (75 percent vs. 50 percent);
- junior lien residential real estate loans over 20 percent of assets would have higher risk weights than banks (150 percent vs. 100 percent);
- commercial loans over 50 percent of assets would have higher risk weights than banks (150 percent vs. 100 percent);
- non-current junior lien loans are risk-weighted higher than banks (150 percent vs. 100 percent);
- treatment of some unfunded off-balance sheet items are risk-weighted higher than banks (credit conversion factor for unfunded commercial loan commitments, etc.).

b) *Impact of Concentration Limits on Credit Unions*

We believe that these risk weights will negatively impact mortgage lending in our community. These risk weights do not appear to accurately capture the risks associated with the respective asset. Indeed, even the banking agencies indicate that certain types of loans do not pose the level of risk that NCUA is projecting. Specifically, NCUA is incorporating concentration risk in these asset categories. BECU requests that NCUA remove the concentration thresholds from the proposed rule.

The constraints put credit unions at a disadvantage compared to banks. Significantly, NCUA has tools to address concentration risk through the supervisory process just as the FDIC does. Ironically (because it limits a credit union's earnings), NCUA's assignment of risk weights may have the impact of curbing capital growth while also disregarding its own policy of providing tools for strengthening credit union's capital because it limits a credit union's earnings. BECU urges NCUA to reconsider the risk weightings. Specifically, we request that NCUA eliminate these concentration risk thresholds for these asset classes and set the risk weights equal to those applied to banks. Additionally, we note that none of the banking agencies has adopted concentration risk thresholds in their risk weights.

**Goodwill**

The proposed rule would subtract a number of components from the numerator portion of the risk-based capital ratio. These subtractions include goodwill, the NCUSIF deposit, other intangible assets, and identified losses not reflected as adjustments to components of the risk-based numerator. In the case of a supervisory merger or consolidation that occurs *before* the publication of the final rule, the proposal would allow credit unions to include goodwill in their risk-based capital numerator until December 31, 2024.

Deducting goodwill from the risk-based capital numerator presents two significant issues. First, it penalizes credit unions who have recently gone through a merger. Second, it could create disincentives for future merger activity. Specifically, the unintended consequence would result in impediments to consolidations of healthy credit unions and consolidations between stronger and weaker credit unions (thereby creating stronger credit unions) in the future.

The credit union industry has seen significant consolidation in the past few years and this is a trend that is likely to continue. Without goodwill available to help balance out the equation going forward, a healthy credit union is less likely to agree to take on a troubled credit union as a partner (even at NCUA's request). This is going to make it harder and more expensive for NCUA to find merger partners for troubled or failing credit unions. Such a result will lead to more expensive liquidations for the NCUSIF. Therefore, BECU requests that goodwill should be added back to the risk-based capital ratio. In the alternative, BECU requests that goodwill counts in NCUA-assisted mergers without an end date. Doing so would give NCUA some flexibility and reduce merger assistance and potential liquidation costs to the National Credit Union Share Insurance Fund in times of stress.

**Interest Rate Risk**

Even though this proposal looks better on paper than the first proposal, almost all of the substantive changes to the risk weights were made to investments after NCUA removed interest rate risk as a criterion under that proposal. The agency has indicated that it is currently considering an alternative approach to address interest rate risk. With this proposal, NCUA is specifically requesting advance comments on alternative approaches to interest rate risk.

At the outset, BECU believes that interest rate risk should be evaluated on a comprehensive basis with the understanding that there is no discrete or perfect solution for all credit unions. There are many factors which may bear on evaluation of a given credit union's interest rate risk, including, among others, capital levels. As part of this process, NCUA should also factor in aspects of management, i.e. how effectively an institution manages interest rate risk. As an aside here, we would suggest that, if a credit union has a rigorous interest rate risk assessment process, interest rate externalities alone should not drive NCUA's assessment of the credit union's interest rate risk.

To better control for interest rate risk, NCUA should continue to apply industry accepted methods as part of a comprehensive supervision and examination process. NCUA has a number of requirements and guidance regarding interest rate risk that credit unions must comply with. These requirements and guidance include the interest rate risk final rule, a Letter to Credit Unions (12-CU-05), and is the top subject in the most recent NCUA supervisory focus (14-CU-01). NCUA has also indirectly addressed the issue of interest rate risk by recently promulgating a final rule to allow federal credit unions to engage in derivatives transactions to mitigate interest rate risk.

Banking regulators account for interest rate risk through their annual examination process by ensuring that banks maintain sufficient capital for interest rate risk. NCUA's existing supervisory and examination mechanisms provide it the same authority to ensure that credit unions have enough capital to absorb the level of interest rate risk on their balance sheets. If NCUA were to promulgate a rulemaking on interest rate risk, the agency would hold credit unions to significantly different standards than banks. Simply put, NCUA's existing supervisory and examination mechanisms provide the agency the appropriate ability to examine interest rate risk at credit unions.

Finally, as a Washington State chartered credit union, BECU encourages NCUA to add a *"sensitivity to market risk"* or "S" component to the CAMEL rating system. Washington is one of eight states that has already added this measurement for credit unions. We believe it would help NCUA obtain a clearer understanding of interest rate risk in the system without imposing any additional regulatory burden for credit unions. If NCUA finds that gaps remain after implementing the "S" component, the agency can undertake a more focused rulemaking to address that shortcoming. BECU encourages NCUA to invest in more rigorous examiner training for this purpose.

**Conclusion**

BECU appreciates that NCUA listened to the 2,000 plus comments from the credit union industry. While this second proposal is significantly better than the first, fundamentally, we do not believe that NCUA has the statutory authority to impose a two-tiered framework regarding capital adequacy. Federal law empowers NCUA to develop an enhanced capital framework for insured credit unions to be adequately capitalized. NCUA's requirement that complex credit unions strive to be well capitalized is contradictory to the plain language of the statute.

BECU remains concerned that this second proposal is not only burdensome but places credit unions at a competitive disadvantage against the banking entities. Coupled with the fact that credit unions weathered the financial crisis far better than the banks, we do not believe there is any practical need for this proposal.

Sincerely,

Kathy Elser
Senior Vice President and Chief Financial Officer