ELITE CAPITAL MANAGEMENT GROUP, LLC
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April 20, 2015

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

Re: Comments on Proposed Rule: PCA – Risk-Based Capital ("RBC2")

Dear Mr. Poliquin:

I am the founder and managing principal of Elite Capital Management Group, LLC ("Elite Capital"), an SEC-registered investment advisor dedicated exclusively to helping credit unions invest their surplus assets in a safe, secure and productive manner. While Elite Capital provides a range of investment services to federal and state-chartered credit unions nationwide, our core focus is on both (i) "pre-funding," whereby credit unions – relying on the expanded employee benefit-related investment authority provided by NCUA Rule 701.19(c) or state parity/other organic legal authority – invest funds not required for member loans in professionally managed, diversified portfolios of publicly-traded direct-issuer government and private debt and equity securities that are beyond the investment limitations of Rule 703, and also (ii) on Rule 703-compliant investments for client credit unions. Elite has consistently delivered for our clients rates of return substantially above those derived from core operations, using portfolios that stress capital preservation; in fact, since 2007, no client has ever experienced a net realized loss in any trailing twelve month period in our programs.

I had commented last year on NCUA's first proposed RBC rule, noting that RBC1 contained excessively general risk weighting categories and lacked tools to draw sound risk distinctions among very different types of investments, such as common and preferred stocks, and took no account of individual private issuer characteristics, such as market capitalization, debt ratings, length as a public company, absence of defaults and financial condition. Beyond eliminating maturity as a weighting factor, RBC2 seems little changed as it applies to non-loan private investments, still taking no account of issuer-specific operational and insolvency risk.

Accordingly, Elite Capital offers the following comments related solely to RBC2's proposed risk-weighting of non-loan private-issuer investments, the space on which we are focused as investment advisors and managers for credit unions nationwide:

1. **Corporate Debt**. Although not permitted under Rule 703, corporate debt issues are allowed and widely used for Rule 701.19 employee benefit pre-funding. RBC2 treats all private issuer corporate debt the same, with a 100% risk weighting. While 100% is not a punitive level, there ought to be some ability for a credit union to demonstrate that the corporate debt it holds should qualify for a lower weighting, closer to the 20% for state and local debt, or the 50% for revenue bonds, which are limited for repayment to the revenue generated by a specific facility and thus often are in reality private issuer obligations. A flat 100% weighting for all corporate

debt takes no account of actual issuer-specific repayment risk, and could well serve to distort reasonable investment decisions by credit unions looking to include such issues in their employee benefit pre-funding portfolios. Some issue/issuer-specific risk assessment must be allowed to more rationally, precisely equal risk and risk weights.

2. **Public Equity**. Also relevant to employee benefit pre-funding investment decisions are publicly-traded equity securities, to which RBC2 assigns a blanket 300% weight. The weighting of all publicly-traded equity at 300% is punitive in nature and unjustified by real world experience with a long list of blue chip, dividend-paying, financially secure stocks Elite Capital regularly includes in CU client 701.19 portfolios. As with corporate debt, some tools must be offered to allow a credit union to obtain relief from the extremely high risk assessment for specific equity issues which are by any reasonable measure secure, certainly more so than consumer loans in default, to which RBC2 assigns a 150% risk weight. Relevant factors which could support a lowering of the risk weighting for specific equity investments include the issuer's debt rating, market capitalization and financial condition, history of dividend payments, and absence of financial defaults. Imposing a blanket 300% weight on all public equity will create two negative, counterproductive incentives for credit unions looking to responsibly pre-fund some of their future employee benefit costs. First, it will discourage any public equity investments, driving down expected overall portfolio return and requiring investment of a larger amount of credit union funds to achieve a needed annual return tied to projected future benefit costs. Second, for those credit unions which do nevertheless include an equity component in their 701.19 portfolios, there will be pressure to overcome the high reserve ratio by investing in higher-return, higher-risk equities, instead of more stable dividend-paying stocks. The treatment of publicly traded equity issues by RBC2 needs further thought and more nuanced treatment.

3. **701.19 Mutual Funds**. RBC2 assigns a flat 300%, punitive risk weighting to pre-funding, non-703 compliant mutual funds. While this baseline weight is subject to reduction under various look-thru methods based upon actual or target fund assets, the starting point of 300% is unjustifiably high in comparison to other weightings assigned to performing and even non-performing loans. This too, requires further inquiry and adjustment.

4. **Employee Benefit Pre-Funding**. All three of the investment asset classes/products noted above are key to most credit union employee benefit pre-funding strategies, whereby CUs attempt to get out ahead of the rising tide of employee health insurance and other benefit costs by investing now to create assets and income to help pay future benefits, rather than rely on an unfunded, pay as you go approach that will over time increasingly stress core earnings, which almost certainly will not grow at the pace of health care and other benefit costs. Assigning excessive and arguably arbitrary weights to those investments which form the core of employee benefit pre-funding efforts will discourage credit unions from trying to responsibly pre-fund at least some of those future costs.

A risk-based capital assessment tool is needed to provide a second look at the basic net worth test applied to all NCUA-insured credit unions. Especially with larger, more complex institutions, the nature and associated investment risk of credit unions assets vary widely and needs to be more accurately assessed and managed. Unfortunately, the proposed RBC2 does not provide credit unions or examiners the flexibility needed to make those assessments. The risk weighting categories for non-loan investments are too general, lumping together assets with widely varying risks, especially when considering risks beyond those tied to interest rate fluctuations. Additional risk weighting tools within categories are needed to properly take account of issuer and security-specific issues for both debt and equity securities and non-703 compliant funds. Failure to do this will both discourage responsible employee benefit pre-funding by penalizing those investments and provide incentives for excessively aggressive equity investing in pursuit of higher returns to offset the especially high reserve requirements.

Once baseline risk weights are more logically assigned among investment asset classes in a revised draft RBC rule, they should be presumptive only, so that if a credit union can present good reasons why a lower risk weight should be assigned to its investments within a certain category, those lower weights will be applied going forward. Examples include credit unions with assets in a diversified portfolio under active, professional management, where the credit union can demonstrate that risks have been effectively measured and managed by asset class, industry and issuer diversification, with ongoing, active portfolio performance measures and real time reporting. This process will more accurately assess asset quality and capital adequacy, and likely entail more interaction between insured credit unions and the NCUA, but the associated administrative demands can be managed by limiting the frequency of risk asset “appeals” by any credit union.

Although the great majority of credit unions are strongly capitalized, Elite Capital supports the NCUA’s attempt to develop a more refined measure of capital adequacy, one that looks beyond generalized net worth to the actual composition and risk characteristics of each insured credit union’s assets. That said, for the reasons noted above, which are specific and limited to credit union non-loan investment programs, we believe RBC2 fails to achieve its stated objective and should be withdrawn for substantial revision, and then re-issued for further public comment.

Elite Capital Management Group brings special perspective and experience to risk-based assessment of non-loan credit union investments, since every day we help client credit unions design and revise their investment portfolios, balancing risk and reward over the long term. We would be happy to discuss this letter and any related questions.

Very truly yours,

Matthew P. Butler
Managing Principal