League of Southeastern
Credit Unions & Affiliates

April 27, 2015

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

Re: National Credit Union Administration - Risk Based Capital Proposal - RIN 3133-AD77

Dear Mr. Poliquin,

The League of Southeastern Credit Unions & Affiliates (LSCU) appreciates the opportunity to comment on the NCUA's proposed-risk based capital rule (RBC2). By way of background, LSCU is a credit union trade association representing state and federally chartered credit unions throughout Alabama and Florida. LSCU represents more than 250 credit unions and their 6 million members.

On January 27, 2015, the NCUA Board issued the much anticipated risk based capital proposal (RBC2) for consideration by credit union supporters and industry stakeholders. The proposal sought to revise the previous Risk Based Capital proposal put forth by the agency in February of 2014. At the same time, credit union advocates spoke out on the proposal. CUNA President/CEO Jim Nussle called the proposal "a solution in search of a problem, particularly given the likely costs to credit unions." Time will tell if that statement is indeed accurate. What is not in dispute is the fact that across the credit union industry healthy capital levels abound and with the costs associated with the proposal and its complexity, credit unions, large and small and leagues across the country have serious reservations concerning its necessity and adoption.

This proposal and its revisions are being touted as now applying primarily to large credit unions and those institutions with assets greater than $100 million and not the small institutions that make up so much of the credit union landscape. The objective of the agency's revisiting of RBC1 appears to be to affirm the intent of the initial NCUA proposal which laid out the agency's plan for updating the risk based capital model and calculation of risk-weighted assets.

This proposal has served as a signal from the Agency and has had the effect of reducing the concerns of many credit unions with regard to being impacted by additional changes to capital rules while multitudes of other regulatory reforms are still in the process of being analyzed and implemented. The League of Southeastern Credit Unions & Affiliates (LSCU) is convinced, however, that the development of new capital requirements would be better served if the process for developing these new standards matched the necessity for them, particularly with regard to public transparency and industry acceptance. We believe advance and substantive engagement with the public and the Congress would better present the Agencies' understanding of the need for major revisions in the rule, as well as how the industry would be impacted by the particular concepts and objectives of the proposal now under consideration.

The 2015 version of risk based capital rules proposal is a marked improvement over the NCUA's previous offering. It is however, flawed in its premise. That flawed premise is that there are problems with the current rules that necessitate the advancement and adoption of major rule changes and operational revisions. Nothing could be further from the truth. As we discuss below, NCUA, in its attempt to emulate an FDIC like risk based capital model has failed to factor in the unique characteristics and cooperative nature of credit unions. As we stated in our previous comments regarding RBC1; LSCU has serious and continuing reservations concerning NCUA's authority to establish a risk-based capital standard for the purposes of determining whether a credit union is well-capitalized. We have seen precious little evidence that indicates to us that NCUA has adequately demonstrated a compelling need to adopt the major changes contained in the RBC2 proposal; we continue to have serious concerns regarding the proposal's capital adequacy plans, risk-weights, and treatment of goodwill. We believe the proposed definition of complex credit union does not adequately reflect the varying levels of credit union complexity found in our industry. We also strongly urge NCUA to offer credit unions greater flexibility than the proposal discloses with respect to providing data on the Call Report and we encourage NCUA to delay the effective date of any final rule until 2022.

Revising Risk-Based Capital Rules

We are disappointed by the apparent desire of some to revise credit union capital rules and regulations to more closely mirror those of other supervisory agencies, particularly those of the Federal Deposit Insurance Corporation (FDIC). While we agree that both the Federal Credit Union (FCU) Act and FDIC regulations provide for the establishment of risk-based capital systems, unique to the Act is a directive that instructs NCUA to take into account the cooperative character of credit unions. We are not aware of such a passage in the FDIC's guidelines. The current proposal NCUA has crafted appears to track the FDIC version nicely but all but ignores the unique cooperative nature of credit unions completely. This approach, according to some industry insiders, gives credence to the feeling among credit union supporters that many of the changes put forth in the past 5 years are aimed at ensuring NCUA rules, regulations, and supervision will eventually mirror the practices and policies of the other federal supervisory agencies.

Credit unions are unique in their cooperative structure, consumer/member focused products and services, and the absence of stock structured, stockholder driven, for profit operations. Credit unions, as not-for-profit institutions are characterized by their risk-averse approach to financial service. Because credit unions historically have taken on less risk, these institutions are not as affected by the ebb and flow of volatile economic cycles. The benefit of this approach is that these institutions, these large and small institutions that dot the landscape across this country, can provide economic balance in their communities, thereby lessening the impact of economic slumps in local economies. While local for profit financial institutions struggle during lean times, credit unions serve their communities as the foundation for better times ahead. We need look no further that the recent financial crisis to see the value of credit unions – in action. While there were some limited difficulties, credit unions unlike their colleagues in the banking sector, remained strong and served as a safe harbor for many undergoing difficult economic times, people helping people. America's working poor and middle class deserve nothing less.

NCUA Statutory Authority to Revise Risk-Based Capital Standards

NCUA is proposing risk-based capital rules that include higher risk-based capital requirements for credit unions categorized as well-capitalized over and above those necessary for a credit union to be considered adequately capitalized, despite the fact that the FCU Act directs NCUA to connect risk-based requirements to the sufficiency of a credit union's net worth only for the adequately-capitalized classification.

NCUA made improvements in this area by lowering the threshold for a well-capitalized complex credit union from RBC1's proposed 10.5% to 10%. This remains well above the proposed 8% requirement for an adequately capitalized credit union. While this treatment is preferable to RBC1, we remain concerned that the new approach is inconsistent with the FCU Act.

Both the regulatory language found in Section 301 of the Credit Union Membership Access Act ("CUMAA"), and the legislative documentation that support it, demonstrate Congress' intent to grant NCUA authority to establish a single risk-based net worth requirement aimed at complex credit unions – thus serving to identify the standard that a credit union must meet to be classified as "adequately capitalized". It did not authorize NCUA to develop a separate risk-based standard for institutions to be classified as "well capitalized." In fact, the language of the Act found in Section 1790d directs that the same risk-based net worth requirement applicable in determining if a complex credit union is "adequately capitalized" must also be applied when determining if that credit union meets the standards necessary to be classified as "well capitalized."

To further confirm the direct nature of the language within the Act, NCUA is directed to design the risk-based net worth requirement to take account of any material risks against which the net worth ratio for an insured credit union to be adequately capitalized may not provide adequate protection. There is little doubt that it was always the intention of Congress that NCUA develop a risk-based capital standard for complex credit unions using a model that synchronizes risk-based capital with net worth requirements for adequately capitalized credit unions, and not set about creating a multi-tiered system with a higher risk-based capital threshold to be used to separate well capitalized credit unions.

To validate the argument against this over-reach of authority by the NCUA, 12 U.S.C. § 1790d(b)(1) provides that agency's PCA system must be both consistent with Section 1790d and "comparable" to the system established under section 38 of the Federal Deposit Insurance Act. NCUA has patterned their approach after that of the bank regulators by proposing a higher risk-based capital requirement for well capitalized credit unions, although the well capitalized risk-based capital ratio under the banker's Basel III is 10% and that is now comparable to NCUA's revised 10% proposal. While NCUA has been careful to track the comparability as directed, under 12 U.S.C. § 1790d (b) Congress also specifically charged NCUA with developing a PCA system that carefully considers the unique nature of credit unions and the not-for-profit cooperative, non-stock model they employ. The fact that credit unions rely on retained earnings to build capital and operate with volunteer boards of directors make their operational structures both unique and challenging. By requiring a higher risk-based capital requirement for well capitalized credit unions, the current proposal fails to take these factors into consideration.

Legislatively, the history of Credit Union Membership Access Act (CUMAA) states that the NCUA Board is only authorized to adopt a single risk-based net worth standard for both "adequately capitalized" and "well capitalized" levels. Correspondence submitted to NCUA by former Speaker of the House Newt Gingrich of Georgia and former Senate Banking Committee Chairman Alfonse D'Amato of New York, two former House members with very divergent views on a variety of issues, confirm that Congress sought to deliberately limit NCUA to issuing a single risk-based capital requirement that would apply to both net worth categories.

For these reasons, insofar as the Proposed Rule purports to establish a dual risk-based net capital system that would impose a different and higher net worth requirement for a complex credit union to be classified as "well capitalized" than to be categorized as "adequately capitalized," NCUA's approach is contrary to the express language of the Act and LSCU does not support its inclusion in the final rule. Given the evidence which appears to overwhelmingly show NCUA does not have the authority to establish a risk-based capital requirement for the purposes of determining whether a credit union is well capitalized, we strongly urge NCUA to revise the proposal consistent with established law.

The Necessity for Revising Risk Based Capital Rules

In addition to the lack of authority for much of its effort in this proposal, we have identified very little in the way of evidence that supports the need for a revision of credit union capital standards, particularly one modeled on the for-profit, commercial bank Basel-style risk-based capital requirements. As CUNA President/CEO Jim Nussle said of the proposal it's "a solution in search of a problem, particularly given the likely costs to credit unions." Even NCUA's own Chairman Matz noted in correspondence to the Governmental Accountability Office, "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 most recent US financial crisis presented financial industry insiders and analysts with an opportunity to study the performance of the US financial system under very real and very strenuous financial pressures. The adequacy of capital requirements and meaningful regulation were just two of the variables under scrutiny during the economic slowdown. Comparisons of the two deposit insurance systems in the U.S., the National Credit Union Share Insurance Fund (NCUSIF) and FDIC's Deposit Insurance Fund during and after the financial crisis demonstrated that the performance of the credit union capital regime, as it is currently constituted, is remarkably healthy. Unfortunately, the bank system did not fair nearly as well and the unacceptable results have led to substantial changes to the FDIC's funding and bank capital requirements. Those changes are not unexpected based on the weaknesses brought to light by the financial crisis. Similar issues were not identified in the credit union system so based on the lack of verifiable evidence to the contrary; we see little justification for NCUA efforts to initiate major rule changes in this particular area.

Proposed Capital Adequacy Requirements

LSCU urges NCUA to remove the capital adequacy provisions from the RBC2 proposal.

Our discussions with affiliate members indicate a great many are concerned about NCUA's proposed capital adequacy provisions. These provisions are viewed with great concern due to their ability to allow supervisory examiners great flexibility in determining if a credit union is to be required to set aside additional capital in spite of the fact that the institution is well-capitalized according to standard net worth and risk-based capital ratio requirements.

Under the current proposal, credit unions designated as "complex credit unions" would be required to develop a capital adequacy plan in order to assess the adequacy of their capital on an ongoing basis, and set aside capital that is over and above the 7% net worth and 10% RBC requirements. The credit union's plan, assessment, and amount of additional capital set aside would then all be subject to supervisory examiner review.

These requirements do not appear necessary for the large majority of complex credit unions based on their management, risk profiles, and current levels of capital. If however, there are concerns regarding a credit union, examiners should address those situations with the individual institution and avoid broad based rulemaking that seeks to implement universal requirements to all 7 complex credit unions, regardless of how well they're performing.

The FCU Act does not generally direct that credit unions be subject to higher capital requirements and credit unions have unique characteristics as evidenced by their lower risk profiles. We therefore disagree with the premise that the thresholds for credit unions to be well-capitalized as established by Congress are in any sense "minimum" capital requirements. Congress did not seek to establish a classification for credit unions to be described as minimally capitalized and had that been their intent we would surely see that reflected in the Act. To our membership, to be well-capitalized means just that. If the required net worth and risk-based capital requirements to be well capitalized have been met, a credit union has then met its obligation and the adequacy of its capital should not be an issue with regard to a requirement that it hold additional capital to be considered well-capitalized. Such a rule is unnecessary to the successful operation of the institution.

LSCU opposes the capital adequacy plan requirements present in RBC2. Credit unions regularly engage in internal assessments to determine the risks it will likely face in addition to establishing its tolerance for risk. Armed with this information each credit union can determine its long-term desired capital ratio. Such a plan, which for many credit unions include margins designed to add additional capital in order to remain above designated regulatory requirements, should not be the subject of examination or supervision and should not be subject to review as part of the examination process.

Complex Credit Unions - Defined

As we stated in our previous comments related to RBC1, the complexity of individual credit unions makes using asset size as the only determinant for whether RBC requirements apply is a flawed practice. We are however, pleased that the threshold for compliance was raised from $50 million to $100 million and that does improve the proposal. We stated in our earlier comment letter that we viewed the $50 million tier as much too low and now $100 million also reflects an inadequate cut-off for application of the rule as well.

As provided for in the Federal Credit Union Act, the NCUA should define "complex" based on the "portfolios of assets and liabilities of credit unions." This indicates to us that it was the intent of Congress that NCUA should follow this guidance as opposed to focusing on the size of a potentially complex credit union alone. If Congress had wanted the application of the PCA rules to be based solely on asset size, it would have directed the agency to apply an institution's asset size when determining which credit unions fell under the "complex credit union" definition. It is our belief that a more appropriate threshold for credit unions and a more consistent reflection of the intent of the FCU Act would require that NCUA increase the proposed $100 million threshold $500 million and that the chosen threshold would be used in combination with actual operational complexity as measured by the agency's Complexity Index. Based on our comments here, we propose that all federally insured credit unions with assets of $500 million or under be exempted from the definition of "complex" and that only federally insured credit unions with assets greater than $500 million with an NCUA Complexity Index value greater than 20 be held to risk-based capital provisions adopted by the Board.

While we recognize that these numbers are open to revision as is any requirement based on a number that increases with inflation in addition to the general growth of an industry, we are more comfortable with an adopted definition that is indexed as is our members. In addition, consistent with the current practice of NCUA, a credit union identified as "complex" should continue to be afforded the opportunity to appeal their status and present evidence to the agency to show why its "complex" status is inaccurate and demonstrate why it should be exempted from risk-based capital requirements. We recommend that the procedure for appealing an NCUA credit union designation of "complex" be detailed in its entirety in the final rule.

Risk Weight Revisions

We are pleased that NCUA has made a number of positive changes to the proposed risk weights found in RBC2. We generally support the removal of weighted average life components from risk weights for investments and changes to risk-weight escalation for higher concentrations of real estate and member business loans. Other examples of improved treatment under RBC2 that we favor include the designation of 1-4 family non-owner occupied mortgage loans as residential loans, subject to lower risk weightings than if NCUA had categorized these loans as member business loans. It is unfortunate, however that RBC2's proposed risk weights remain far too high in key areas, in view of credit unions' manageable level of risk, additionally, these risk weights should be lower than those the federal bank regulators require for assets such as mortgage loans, member business loans, servicing and certain investments. Lower risk weightings for credit unions are appropriate given their different incentives to manage risk as compared to commercial banks, and lower loss history as chronicled in agency data and individual credit union histories.

Risk weights for credit unions should be adjusted downward to levels no greater than those currently in place for commercial banks in light of the fact that credit unions do not operate at higher risk levels due to their holding of these assets. A review of credit union data would validate this position as entirely appropriate given lower loss rates at credit unions.

A comparison of credit union versus commercial bank risk weight applications indicates a visible disparity between the two. For credit unions, current first lien residential mortgage loans over 35% of assets would have a risk weight of 75%, 25% higher than the 50% risk weight assigned to banks. Current and non-junior lien real estate loans over 20% of assets would also have higher risk weights than applied to commercial banks. Also, credit union business loans that totaled over 50% of assets would reflect a risk weight of 150% while the weighting for bank business loans over 50% of assets could be as low as 100%. There is a clear disparity in the treatment of risk weights applied to banks and credit unions and we urge the NCUA to address the issue prior to adoption of a final rule.

LSCU fully supports the proposal where no separate risk weighting would apply in the treatment of consolidated credit union service organization (CUSO) investments and loans. While that is a positive step, the unconsolidated CUSO investment risk weight remains too high. A reasonable solution would be for CUSO investments and CUSO loans to carry the same risk weight, 100% under RBC2.

Additionally, there is little doubt that the 250% risk weighting for mortgage servicing, carried forward from RBC1 and matching that weight applied to banks, is too high and should be significantly lowered prior to the adoption of RBC2.

Goodwill and Other Intangible Assets

In the original 2014 proposal, goodwill and other intangible assets (OIA) would have been excluded from the numerator of the risk-based capital ratio. Revisions present in RBC2 indicate a subset of goodwill and OIA could be retained in the numerator of the RBC ratio until the year 2025. That subset would however, be limited to goodwill and OIA that arise from "supervisory" mergers prior to one month after publication of the final rule. Supervisory mergers would be broadly defined as assisted mergers, emergency mergers, or mergers where the NCUA or state supervisory authority selected the surviving credit union.

LSCU considers the retention of goodwill and OIA in the RBC numerator until 2025 an improvement over the original proposal. We are concerned however, that the treatment present in the revised proposal does not go far enough. LSCU believes that the inclusion of all goodwill and OIA in the numerator is far more beneficial to credit unions as long as these intangible assets meet Generally Accepted Accounting Principles (GAAP) requirements and by that we mean that they are subject to annual goodwill impairment testing.

We further believe that by excluding non-supervisory goodwill from the numerator many well managed and well-capitalized credit unions will be disqualified from participating in potential merger activities thereby eliminating the opportunity for institutions and their members to benefit from the combined strengths of both credit unions as they join together to form one stronger institution.

Regardless of whether NCUA chooses to eventually permit non-supervisory goodwill in the numerator, LSCU sees value in allowing previous supervisory goodwill by grandfathering it into the process. The reasons for this view include the benefit to the share insurance fund by those credit unions that have engaged in these transactions. These credit unions initiated their activities with an appreciation of the rules in place at the time and the amount of goodwill involved is relatively small. So small, in fact, that the act of grandfathering would protect and reward those credit unions that in the past contributed to reducing NCUSIF resolution costs and aid and incentivize those institutions that act similarly in the future.

Revised Call Report Data Requirements

NCUA's proposed rule seeks to change the Call Report to enable the collect of data on a number of new elements present in the proposal. If adopted, these changes will require credit unions to provide more detail regarding current collected data present on the Call Report and to acquire and report new data not presently required.

LSCU generally supports the collection of the additional data through the Call Report with one important caveat; we strongly urge NCUA to ensure the changes that will affect all reporting credit unions are not overly onerous and can be accomplished with a minimum of disruption to credit union operations. For example, we would like to see NCUA employ a method in which credit unions would gather the detailed information in the proposal electronically and report that data if requested to do so by the agency. Such an approach could be accomplished through programming changes that include adding additional data fields and increasing the data detail within existing fields of the Call Report. Upon receipt of a valid agency request, the institution would "flip the IT switch" and data, gathered previously, would populate the Call Report submission. It is our understanding that other supervisory agencies are already managing their data needs in a manner similar to this process. We believe this is an alternative approach to data management worthy of additional NCUA consideration.

The NCUA is on record as stating that "The Call Report changes prompted by this proposed rule are the kind that would easily be handled as part of the normal and routine maintenance of a credit union's data reporting system." While that may be true, we remind the agency that all programming changes made to an institution's internal systems involve the expenditure of time and resources. NCUA would be well served to consider the amount of time and effort many credit unions are expending in an effort to either implement or comply with rules from NCUA and other supervisory agencies. We therefore strongly urge NCUA to consider all alternatives that reduce the burden of RBC2 and its implementation.

Supplemental Capital for Prompt Corrective Action

We have long supported the use of supplemental capital as a means by which any complex federally insured credit union can meet its RBC obligations. We believe the NCUA has the authority to permit supplemental capital for RBC purposes and we urge NCUA to include such a provision in the final RBC2 rule adopted by the Board.

While we understand that a change in federal law would be necessary to enable credit unions to include supplemental capital in net worth, we also are of the opinion that NCUA is not prohibited by either the FCU Act or GAAP from including supplemental capital in the numerator of the risk-based capital ratio for

RBC. There are already items present that are not a part of net worth making this step feasible for our member institutions. Therefore, we recommend its adoption for the benefit of all credit unions.

NCUA has taken steps in the past ultimately serving to allow supplemental capital for RBC purposes. NCUA should simply refer to these events and permit the use of supplemental capital to meet RBC requirements for federal credit unions and, where permitted across the country, for state chartered credit unions.

Further, as part of NCUA's annual review of regulations, we encourage NCUA to seek the revision of current or enactment of future legislation that would authorize the use of supplemental capital as net worth for the purposes of prompt corrective action. We are reminded that NCUA has stated its support for such action in the past and we encourage the Board to work toward its enactment.

Interest Rate Risk Rule Requirements

LSCU does not support the inclusion of a separate standard to account for IRR at credit unions. For years the NCUA has blanketed credit unions with correspondence and communications addressing the issue of interest rate risk. As recently as September 30, 2012, the NCUA's final interest rate risk rule took effect. That rule imposes different requirements on federally insured credit unions based on asset size. Additional requirements include the development and adoption of a written policy on IRR management and a program to effectively implement that policy as part of their asset-liability management responsibilities. We do not disagree that a formalized program is beneficial to the proper management of interest rate risk however; we oppose what amounts to a separate IRR standard among credit unions to address this issue.

NCUA's revised RBC proposal appears to suggest that a separate IRR rule is necessary and that such a standard should be based on a process that includes a comprehensive balance sheet measure that takes into account offsetting risk effects between assets and liabilities. Such a process is thought to be capable of assessing IRR consistently across all asset and liability categories. By doing so the method would account for rising and falling rate scenarios thereby supplementing the supervisory process with a method designed to account for those credit unions severely challenged by interest rate risk issues.

To that end, in an effort to address any credit union that fails to adequately meet its IRR obligations, the agency could view such institutions as "severely challenged IRR institutions." In these cases, the institutions would be subject to more detailed analysis and dialogue with the agency within the scope of the examination process. In essence this would be an early warning procedure with the opportunity for the agency to allocate resources such as the NCUA's Capital Markets/ALM specialists who would then closely evaluate each identified credit union.

This interaction procedure would continue until such time as the credit union in question could demonstrate to NCUA examiners that their interest rate risk was being appropriately measured and managed. If this interaction failed to bring about the desired level of performance, an institution could then be subject to various enforcement actions until their performance no longer reflected a negative IRR position.

Finally, with the multitude of rules changes produced over the past several years, there's no reasonable benefit to burdening credit unions with yet another new and complicated IRR obligation. Instead of producing yet another unnecessary rule, perhaps the NCUA's attention could be redirected toward that small number of institutions that continue to struggle with managing IRR. NCUA can and in many cases has already identified those credit unions through the examination process. This would appear to be a better use of resources by the agency and one we could support.

Implementation Timeline

We appreciate that NCUA has proposed a significant delay in the implementation of RBC2, but we encourage the agency to delay implementation even further—until 2021—to permit the planning and operational changes necessary for credit unions to adjust internally to the requirements of the revised rule. We believe this time frame to be reasonable given the impact of the new rule on credit unions and the probable need to initiate asset/liability management changes, procedural and balance sheet adjustments and CEO/board decisions on how best to proceed in view of the new requirements the passage of RBC2 brings.

Conclusion

On behalf of our affiliate credit unions and their members, thank you for the opportunity to comment on this proposed rule. As stated earlier, we consider the proposal inadequate for its stated purpose and question NCUA's statutory authority to impose its contents upon America's credit unions. We strongly urge NCUA to withdraw the proposal and, if intent on moving ahead with its adoption, we encourage NCUA to make significant revisions to the proposal consistent with the comments we have offered.

Regards,

Scott Morris
Director, Regulatory Advocacy