NEW YORK creditunion ASSOCIATION

strength in members.

April 27, 2015

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

Risk-Based Capital, 80 FR 4340-01

Dear Mr. Poliquin:

On behalf of the New York Credit Union Association, I am writing this letter to comment on NCUA's Risk-Based Capital proposal. I join with the vast majority of New York credit unions that are impressed by the degree to which NCUA analyzed the first round of RBC comments and made important changes, such as raising the compliance threshold, lowering many risk weightings and increasing the number of credit unions that would be "well capitalized." But even with these important changes, RBC reform is still a solution in search of a problem. There is simply no pressing legal or policy justification for imposing fundamental capital reform on credit unions. If NCUA goes forward with this proposal, there are several additional changes that should be made including: reducing its authority to establish unique buffer requirements for individual credit unions; further adjusting risk weightings; and raising the compliance threshold to at least $500 million.

The existing PCA/RBNW System ensures the safety and soundness of credit unions.

NCUA argues (1) that it needs a more complicated RBC system to enhance the safety and soundness of the credit union system and (2) that the Federal Credit Union Act requires NCUA to make its RBC framework more compatible with the banking industries' RBC framework following the codification of BASEL III risk weightings. Neither of these justifications withstands scrutiny.[1]

[1] In explaining why he supported RBC reform, former board member Michael Fryzel explained that " Credit unions are not statutorily covered by Basel, but NCUA is required to maintain a system that is 'comparable' to that of the banking industry."

1021 WATERVLIET-SHAKER RD. * ALBANY, NY 12205 * P.O. BOX 15118 * ALBANY, NY 12212-5118
(518) 437-8100 * (800) 342-9835 * FAX (518) 437-8500 * WWW.NYCUA.ORG

The Great Recession presented credit unions with the greatest test of their safety and soundness since the 1930's. The industry performed well enough for researchers to conclude that credit unions are less sensitive to economic downturns than are banks. For example, the trajectory and magnitude of delinquencies and charge-offs were more pronounced at banks than at credit unions, and credit unions did not restrict credit as quickly or severely as did banks. In fact, the performance of natural person credit unions led these researchers to conclude that regulators should consider lowering credit union capital requirements.[1]

In contrast, NCUA is effectively penalizing well-performing institutions with a mandate to re-evaluate their portfolios, train staff and buy new software in order to make their RBC framework more analogous to a banking industry that under-performed during the financial crisis.

NCUA is not compelled to make RBC reforms.

Much of the debate over RBC reform has centered on a dispute about the precise risk-based requirements imposed on credit unions.

The Credit Union Membership Access Act, Pub. L. 105-219, 112 Stat. 913 (1998), mandates that NCUA promulgate a regulatory "framework combining mandatory actions prescribed by statute with discretionary actions developed by NCUA; (2) an alternative system of PCA to be developed by NCUA for credit unions which CUMAA defines as "new"; and (3) a risk-based net worth requirement to apply to credit unions which NCUA defines as "complex."[2] CUMAA further stipulates that NCUA's PCA system must be comparable to section 1831o but account for the fact that credit unions are not-for-profit cooperatives.[3]

In promulgating CUMAA's regulations, the PCA comparability requirement and the risk-based requirement were treated as two distinct mandates. In February of 2000, NCUA finalized the regulations that created the modern PCA system.[4] It was designed to closely track the broad outlines of 1831o. It places all federally insured credit unions in one of five categories established for banks based on their net worth ranging from Well Capitalized to Critically Undercapitalized. In addition, both 1831o and NCUA regulations authorize Capital Restoration Plans for poorly performing institutions.

In the preamble to the PCA regulations, NCUA repeatedly emphasized how its PCA system was modeled after 1831o. For example, the power to reclassify a credit union's net worth categorization was "modeled on a parallel provision of FDIA §38. § 1790d (h); 12 U.S.C. 1831o (g)." In another part of the preamble, it explained that "[c]onsistent with its statutory mandate,

---

1 ***Withstanding a Financial Firestorm: Credit Unions vs. Banks*** *By David M. Smith, PhD, Associate Professor of Economics, Graziadio School of Business and Management, Pepperdine University and Stephen A Woodbury, PhD, Professor of Economics, Michigan State University May 17, 2010.*

2 65 FR 8560-01, February 18, 2000.

3 12 U.S.C.A. § 1790d (West).

4 65 FR 8560-01, February 18, 2000.

NCUA attempted in the proposed rule to craft Discretionary Supervisory Actions which are 'comparable' with the 'discretionary safeguards' available under the system of PCA that applies to banks, yet which suit the distinctive needs and characteristics of credit unions."[5]

NCUA promulgated its RBNW framework in a separate regulation finalized in July of 2000. It explained that the RBC requirements were designed to act "independently" of the general system of PCA.[6] The preamble to this regulation makes no reference to the system's compatibility with 1831o, nor could it: The RBNW system for complex credit unions is vastly different than the RBC system implemented for banks in 1989. The regulation defines a relatively small number of assets and investments with corresponding weightings. It was primarily concerned with interest rate risk.

This is because Congress intended, and NCUA understood, that the comparability mandate only applied to the general system of PCA and not the Risk-Based Capital requirements to be imposed on complex credit unions. Specifically, "section 216(b) of the bill requires the NCUA to prescribe, by regulation, a system of prompt corrective action for federally insured credit unions that is consistent with the specific restrictions and requirements of new section 216 and comparable to section 38 of the Federal Deposit Insurance Act."[7] Whereas section 216(d) requires the NCUA, by regulation, "to prescribe a risk-based net worth requirement for federally insured credit unions that are complex, as defined by the NCUA... and be designed to take into account any material risks against which the 6 percent net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection."[8] Given this regulatory and legislative history, it is perplexing that NCUA would suddenly suggest that changes to the RBC system for banks require NCUA to refine its RBC framework. Banks had an RBC framework that had been heavily influenced by BASEL reforms when CUMAA was passed and implemented in 1998. To the extent that NCUA's PCA system complied with the compatibility requirement then, it complies with it now.

The history of CUMAA and its enacting regulation also reinforces the well-documented argument that complex credit unions are only required to be "adequately capitalized" for RBC purposes. Sections 216(b) and 216(d) imposed two distinct and unrelated mandates: PCA requirements and RBNW requirements. The requirement to be well capitalized applies to all credit unions; whereas the requirement to be adequately capitalized for risk-based net worth purposes is an additional mandate that applies only to complex credit unions and only to the extent that traditional PCA requirements don't ensure that these complex credit unions are adequately capitalized in relation to their more complex activities.

[5] §1790d (b) (1) (A" (Prompt Corrective Action, 65 FR 8560-01, 8570.

[6] Prompt Corrective Action; Risk-Based Net worth Requirement, 65 FR 44950-01, July 20 2000.

[7] See S. REP. 105-193, 12.

[8] See S. REP. 105-193, 14.

Given the strength of complex credit unions, there is certainly no need for a huge expansion of the RBC system. Such a system is only a fail-safe intended to ensure that these institutions are adequately capitalized.

The compliance threshold should be raised to at least $500 Million.

If NCUA concludes that it still must implement RBC reform, then the compliance threshold should be raised to at least $500 million. A $500 million threshold would be compatible with NCUA's attempt to align its RBC framework more closely with that of banks. As of 2013, banks with assets of $500 million or less are considered small for purposes of the Regulatory Flexibility Act. In addition, Small Bank Holding Companies with $500 million or less in assets are generally exempt from the BASEL III requirements.[9] Further, relief is given to even larger banks since some of the most advanced risk-based requirements only apply to banks with consolidated assets of $50 billion or more.[10]

$500 million is also a better proxy of complexity than is $100 million based on the current condition of the industry. According to NCUA's Chief Economist in his December 2014 report on economic trends, membership growth at credit unions with $1 billion or more in assets recently exceeded 8% and has averaged 6% over the last five years. In contrast, membership growth for credit unions with $500 million or less in assets has fallen for each of the last four years.

Finally, in deciding which credit unions should be subject to enhanced RBC requirements, NCUA should consider the substantial compliance burden necessitated by new RBC requirements. Even though almost all of New York's credit unions are "well capitalized" under the revised RBC plan, impacted credit unions will still have to acquire new software, educate staff and board members, and potentially reconfigure existing loan and compliance policies. Given the number of mandates with which credit unions must comply, only those that pose the most direct threat to the Share Insurance Fund should be subject to these mandates.

NCUA should adopt an "Asset Plus" approach to defining credit unions as complex.

In its preamble to this proposal, NCUA has asked if criteria other than asset size should be used in classifying credit unions as complex. Many New York credit unions would be supportive of an approach that would classify a credit union as complex only if it is both above a minimum asset size and engages in a combination of risky activities identified by NCUA. Size is not a sufficient proxy for complexity given that there are certainly larger credit unions that have conservative portfolios and product offerings.

---

9 Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 FR 62018-01, 62024.

10 Federal Register /Vol. 77, No. 169 /Thursday, August 30, 2012 / Proposed Rules 52795.

Even as many credit unions favored an Asset Plus approach to complexity designations, others welcomed the certainty provided by a bright-line numeric rule for classifying a credit union as complex. Consequently, NCUA should only adopt an Asset Plus approach if it is willing to phase in a credit union's RBC requirements over a four-year period.

In the alternative, NCUA should give individual credit unions the right to seek a waiver from a "complex" designation. This will ensure that credit unions that are properly managed and continue to grow are not subject to RBC mandates if they are not inherently complex.

NCUA should further restrict its individual buffer requirements.

The Association supports NCUA's decision to remove the Individual Minimum Capital Requirement in this revised proposal. Credit unions were concerned that it empowered NCUA to micromanage even well-run credit unions by authorizing it to impose capital constraints on institutions otherwise in compliance with capital requirements. However, credit unions justifiably remain concerned that NCUA is still seeking similar powers but with less guidance detailing when it will be utilized. In the preamble, NCUA asserts that it will "be able to address any deficiencies in a credit union's capital levels relative to its risk by: (1) Reclassifying the credit union into a lower net worth category under § 702.102(b) of this proposal and the FCUA; (2) determining in relation to proposed § 702.101(b) that capital levels are not commensurate with the level or nature of the risks to which the credit union is exposed; or (3) using other supervisory authorities to address unsafe or unsound conditions or practices as noted in §702.1(d) of this proposal and the current rule."

The allocation of resources is the core responsibility and prerogative of credit union management. If NCUA has the authority to establish buffer requirements unique to a given credit union, then it is reserving for itself the authority to make examiners and not boards the arbiter of asset allocations even when a credit union is well capitalized. If NCUA goes forward with this broad authority, it should provide detailed guidance explaining the conditions under which examiners will be able to impose increase buffers or downgrade a credit union's management.

Risk weightings should be reduced.

Although certain risk weightings have been reduced, some need to be reduced even further to reflect the unique needs of the credit union industry.

Even though the risk weighting for an investment in an unconsolidated CUSO has been reduced to 150 percent, this weighting still signals that NCUA considers a credit union's CUSO investment to be among the riskiest that can be made. All CUSOs get the same weighting, regardless of its business or the concentration risk it poses. NCUA should consider an alternative approach based on banking regulations. Under banking regulations, investments in the aggregate amount of a banking organization's unconsolidated financial institutions is not risk weighted until it exceeds 10 percent of a bank's tier 1 capital. This approach, if adopted for credit unions, would remove the disincentive to invest in CUSOs. A second approach, advocated by some New York credit unions, would require NCUA to weight CUSO investments based on the nature of the activity carried out by the CUSO; this approach would allow regulators to account for the fact that not all CUSO investments represent an identical level of risk. For example, an investment in a CUSO that provides back office processing for smaller credit unions is not the same as an investment in a CUSO specializing in indirect lending. Another weighting that should be reduced includes investment in corporates. The Association continues to feel it is unfair to encourage credit unions to recapitalize the corporate system only to subsequently seek to penalize them for making these investments.

I want to thank NCUA once again for conscientiously reading industry comments and returning with a revised proposed regulation. I hope that NCUA will conclude that now is not the time to be imposing a new mandate on credit unions. If it does go forward, many of the recommendations I have made in this letter would reduce the burden imposed on impacted institutions.

Sincerely,

William J. Mellin
President/CEO
New York Credit Union Association