Dow Chemical
Employees' Credit Union

April 27, 2015

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

RE: Comments on Second Proposed Rule
Prompt Corrective Action - Risk-Based Capital; RIN 3133-AD77

Dear Secretary of the Board Poliquin:

Thank you for the opportunity to comment on the second Proposed Rule on Risk-Based Capital (RBC2) to restructure Prompt Corrective Action (PCA) regulations. Dow Chemical Employees' Credit Union (DCECU) is a $1.5 billion, state-chartered, federally insured credit union located in Midland, Michigan that serves over 57,000 members. We have modeled the impact of this second proposed rule on our credit union and our current assessment reflects a sufficient risk-based capital cushion with no expectation of any concern in the immediate future.

DCECU maintains that a two-tier capital system for credit unions seems burdensome and unnecessary given their historical and current strong capital positions. We request that this proposed rule be withdrawn since a system that imposes standardized measures/weightings, by definition, cannot allow unique credit union assessments of its overall capital adequacy in relation to its risk profile [RBC 702 § 101]. Further, since this is largely based on credit risk, NCUA might wish to review FASB's CECL proposal to determine if it favorably addresses uniqueness compared to the one-size-fits-all approach.

However, if a risk-based capital system is imposed, we wish to provide comments to continue to shape this regulation to be more balanced. We provide the following comments and suggested modifications to this proposal to achieve the following objectives; 1) reducing complexity and easing the burden for all credit unions, 2) ensuring the overall safety and soundness of our industry and 3) providing a meaningful assessment of the unique risks of each credit union.

DCECU applauds the NCUA's response to over 2,000 public comments on the original RBC proposal. Specifically, we appreciate the following improvements:

- reducing the risk weights for many asset classes
- removing the interest rate risk components from the risk weights
- lowering the minimum risk-based capital ratio level required to be classified as well-capitalized from 10.5 percent to 10 percent
- raising the threshold from $50 million to $100 million in total assets to define a complex credit union under this rule
- permitting existing goodwill in "supervisory" mergers to be included in the RBC numerator temporarily until 2025
- removing the individual minimum capital requirement provision
- eliminating the cap on the amount of the Allowance for Loan and Lease Losses accounts included in the numerator for RBC ratio, and
- extending the implementation timeframe to January 1, 2019.

Your efforts to reduce regulatory burden and complexity, especially for those credit unions less than $100 million in total assets, while allowing sufficient time for implementation, reflects positively on the NCUA as an open and responsive regulator.

In concept, DCECU can support a risk-based capital concept for credit unions as it is a good foundation for ensuring the strength of our industry. We can appreciate clear, defined guidelines and desire tools to guide business decisions that impact capital. Further, it is understandable that the NCUA, as administrator of the National Credit Union Share Insurance Fund (NCUSIF), would like credit unions to retain as much capital as possible, certainly enough to offset specific institutional risk. However, DCECU believes that it is critically important that credit unions are able to free up capital, put it to strategic use in order to support future growth – and that this ultimately benefits the long-term viability of the NCUSIF. Again, we emphasize that a simplified, one-size-fits-all model, however, might not truly represent both the risks and the uniqueness of each credit union and we wish to share our concerns with this proposal

If this rule continues to move forward, the improvements outlined above are moving in the right direction. However, while we are grateful for all of these revisions, we continue to maintain that a risk-based capital program for credit unions is unnecessary and this proposal should be withdrawn.

INCREASED BURDEN

Despite the many positive changes to this proposal, additional call report and other data collection will still be required to show compliance with this rule and may be administratively burdensome without adding the expected value. We can support these additional efforts if they accurately assess each individual credit union's risk profile and do not adversely affect healthy credit unions' ability to meet the financial services needs of their members.

QUANTIFICATION

DCECU questions where the minimum RBC threshold to be well capitalized at 10% comes from. Has NCUA looked at a cross section of credit unions with the calculated

lowest risk profiles? Would the 10% minimum represent higher than necessary levels of capital for these credit unions? We would like to ensure that 10% is not arbitrarily set creating an additional artificial capital "buffer."

Additionally, DCECU still maintains as discussed in our previous letter that deducting the NCUSIF Capital Deposit from both the numerator and denominator in RBC requires "additional" capital to be maintained when this same requirement is not in place for current PCA purposes. We are aware of the 2012 GAO study, but feel the analytics outweigh NCUA's justification.

DEFINITION OF COMPLEX CREDIT UNION

Within the proposal, the NCUA made several inquiries regarding the definition of "complex." What makes a credit union "complex?" While it may be the types of products and services that the credit union offers, complexities in their balance sheet or perhaps the quantity of higher risk activities undertaken, it certainly should not be defined by the asset size of the credit union. It is very likely that a small credit union could pose a much larger risk to the NCUSIF than a larger credit union. We understand that a line must be drawn somewhere and asset size is easy and clean. Using assets as a threshold for complexity suggests that capital is not as critical for smaller institutions and clearly this is not the case. Assets or any other similar numeric measurement seems less relevant than using proper judgment and oversight during the supervision process.

Is it "complexity" that we need to define – or is it ultimately the quality of the management of the risks undertaken by the institution? Isn't this ideally measured by the "M" in the CAMELS rating? Perhaps a deeper analysis as to whom this risk-based capital mandate should apply would best be determined during the supervision process, such that those credit unions posing a higher risk to our shared insurance fund would have higher standards and expectations to abide by. This solution would reduce the "broad-brush" effect of the current proposal, applying more stringent standards on those institutions that may benefit from regulatory risk management and thus provide greater protection of the NCUSIF.

UNIQUENESS OF CREDIT UNIONS VS. PARITY WITH FEDERAL BANKING STANDARDS/RISK WEIGHTINGS

While we have appreciated the attempted parity of the proposed risk weights to FDIC-insured institutions, we maintain that credit unions have earned unique treatment. While credit unions are financial institutions, they generally utilize a different risk model than their for-profit counterpart banks. Credit unions reduce their risks through higher quality credit with stronger underwriting of known member loans, demonstrated by lower loss ratios. Both the historical and distinct risk profiles of member-owned credit unions should earn them lower risk-based capital requirements.

While we have appreciated most of the modified risk weightings in this second proposal, we do not feel that the NCUA has gone far enough to account for the unique risk profile of credit unions in the following areas:

LOANS:

1. **Share Secured Loans,** while lowered to 20%, still does not obtain parity with our FDIC-insured banking counterparts. Loans fully secured by funds held on deposit at our institution should result in a near-0% risk weight.
2. **Government-guaranteed portion of loan** balances remains at 20% risk-weight, despite the full backing of the US government.
3. **Current Secured Consumer Loans** could easily be risk-weighted at 50%, instead of 75%, given the historically low default rate of these loan types, strong underwriting and further protection by the underlying collateral.
4. **Current Unsecured Consumer Loans** were increased to 100% for parity with banks. However, the initial 75% risk-weighting is more reflective of credit union loan risk, given our loss history.
5. **Current non-federally insured student loans** remain at 100% risk-weight, despite other potential sources of insurance. Should there be a distinction at least for insured private student loans? Could this be broken down into insured private student loans at 50% risk-weight and uninsured private student loans at 100%? At DCECU, private student loans are not only insured by an independent insurance company, but reinsured with three separate carriers. In this situation, a 100% risk-weighting seems excessive.
6. **Non-current** (90 days past due) **Consumer Loans,** similar to #3 above, could easily be risk-weighted at 100%, instead of 150%, given the historically low default rate of these loan types, strong underwriting and possible further protection by underlying collateral.
7. **Current first-lien residential real estate loans >35% of assets** risk weightings exceed that of FDIC-insured banks (75% to 50%). The bank model only addresses credit risk, whereas RBC2 continues to address both credit **and** concentration risk for credit unions. Why should credit unions receive a greater penalty for this concentration risk? Parity is requested.
8. **Current junior lien real estate loans > 20% of assets** risk weightings also exceed that of FDIC-insured banks (150% to 100%). The bank model only addresses credit risk, whereas RBC2 continues to address both credit **and** concentration risk for credit unions. Why should credit unions receive a greater penalty for this concentration risk? Parity is requested.

   NOTE: Both #7 & 8 (types of loans) above amortize over time lessening their credit risk profile, and in the case of junior liens, over time, they can become first liens, at which time the risk weightings become too conservative. This reduction in risk will not be accounted for in the current proposal.

OTHER ASSETS:

1. **Investments in CUSOS (Unconsolidated).** While the unconsolidated CUSO investment risk weight was reduced from 250% to 150%, CUs are still required to hold $1.50 in capital for every $1.00 invested in CUSOs. While involvement or investment in a CUSO may pose some risk, one of the primary

reasons for CUSO utilization is to manage risks through collaboration, expertise and management of a particular business. One must also acknowledge that not all CUSOs are equal and exhibit varying levels of risk to their investors. Should all be treated the same with the same risk weight? If so, this will likely dissuade CUs from working together toward mutually beneficial solutions. While DCECU currently has limited CUSO investments (currently only the CO-OP ATM network) and is not adversely impacted under the proposed rule, we do not support what appears to be an excessive risk weighting relative to the risks of most CUSOs. This appears to contradict one of the fundamental principles of the CU movement, "cooperation among cooperatives."

While this may slightly increase the overall burden or complexity of data tracking, could a sliding scale risk weight be applied whereby the risk weight percentage is indexed to the percentage of initial investment that is reimbursed over time? Once the initial CUSO investment has been recovered in full, we propose that the risk weight should be reduced to 0%. At a minimum, the risk weight for unconsolidated CUSO investments should be no higher than that for Loans to CUSOs at 100% as these are comparable.

INTEREST RATE RISK/SUPPLEMENTAL CAPITAL/RISK BASED SHARE INSURANCE PREMIUMS AND REQUEST FOR DELAY OF IMPLEMENTATION

While we are grateful that interest rate risk (IRR) components have been removed from the risk weights, we strongly believe that a new rule on IRR is unnecessary. The current NCUA interest rate risk rule provides adequate protection and is further supported by Basel III and the FFIEC 2010 Advisory on Interest Rate Risk Management. A standardized rule will be unable to take into account the uniqueness of each credit union and might unnecessarily restrain risk management. We suggest that perhaps IRR is better addressed through the examination and supervision process of each individual credit union or as part of overall capital adequacy considerations.

Additionally, we would appreciate NCUA support of legislation to authorize the use of supplemental capital as net worth for the purposes of prompt corrective action. Comprehensive capital reform must include access to supplemental capital for all credit unions.

Finally, if Interest Rate Risk, Supplemental Capital and Risk-Based Share Insurance Premium changes are likely in the near future, we request a delay of finalization and implementation of this proposed rule until a comprehensive analysis can be conducted to ensure an integrated, aligned approach to risk-based capital. Lack of coordination and addressing interest rate risk, supplemental capital, risk-based share insurance premiums and risk-based capital in silos will not create the most efficient and effective solution.

Summary

Overall, DCECU maintains that a regulated risk-based capital rule will be burdensome and unnecessary with very little benefit to the credit union industry. Thus, we encourage NCUA to withdraw this proposed rule altogether. Expecting that a new rule may be forthcoming nonetheless, we thank the Administration for reading and responding to the 2,000+ comments initially received and look forward to further consideration of comments received on this second proposal. Withdrawal of this rule along with consideration of an experience-based index defined through the supervision/examination process might prove more useful to better capture institution-specific risk. Consideration of each credit union's historical performance (CAMELS ratings) and loss ratios are important factors when assessing risk.

Thank you in advance for your thoughtful consideration of the comments expressed herein. We are hopeful that the final rule will be withdrawn. Short of that, please work to reduce regulatory burden, maintain the financial health of credit unions and continue to enable each credit union to meet the unique financial services needs of their members without unnecessary regulatory restrictions or impediments. DCECU wishes to be part of the solution and would be willing to discuss or participate more fully regarding any or all of the points made above. Please find my contact information below if additional discussion is desired.

Sincerely,

Dennis M. Hanson
President/CEO
Dennis_Hanson@dcecu.org
989.832.4888

cc: U.S. Congressman John Moolenaar
U.S. Senator Debbie Stabenow
U.S. Senator Gary Peters
Jim Nussle, President/CEO, Credit Union National Association
Dave Adams, President/CEO, Michigan Credit Union League