Christopher O. Howard
2214 North Scott Street
Arlington, VA 22209

March 25, 2014

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

Comments on Proposed Rule: Risk-Based Capital

Dear Sir:

I am a member-owner of Arlington Community Federal Credit Union. A year ago, as a former banker and relatively new convert to credit unions, I wrote a comment letter asking that the first proposed rule on Risk-Based Capital be withdrawn. Failing that, I asked for heavy revision and resubmission for additional comment. Seeing the effort put forth by the NCUA to revise the proposal, I feel compelled to write once again.

Last year's proposal was a bad idea, poorly executed. We can argue whether all the revisions improve the execution, on balance – and with some significant exceptions – I'd say yes. I'd also say it doesn't matter. The entire notion is still a very bad idea. It's a truism that no matter how well you execute a bad idea, the result will still be bad. So it is with this proposal. It is bad for credit unions, bad for credit union member-owners like myself, bad for the movement, bad for the cause of financial cooperatives, and ultimately I suspect, even bad for the NCUA itself.

Once again, I am forced to write: "Withdraw this rule."

Simply put, Risk-Based Capital standards are a failed experiment that have never worked as intended regardless of the implementation. For credit unions, they are a particularly ill-suited solution to a problem that does not exist and never has. At best, the rule is the product of dysfunctional understandings of four key concepts: credit risk management, deposit insurance, the structure of financial cooperatives, and the regulatory process.

There is no way to fix this.

As I noted in my prior letter, I appreciate the logic of risk-weighting assets: It is self-evident that some loans are inherently riskier than others and ensuring sufficient capacity to cover losses is a requirement of responsible lending. But,

1. Capital is a lousy tool for this – expensive, inflexible, destructive to use, and impossible to target directly at whatever risk is creating concern.
2. Any systemic rule like this must be relatively simplistic and inflexible, but credit risk management is a complex and nuanced thing. It does not scale well.

Setting everything else aside, this rule serves no constructive purpose and can never work as advertised. A trailing indicator cannot be a "tripwire," which is why a CUNA study shows that only one of the 189 credit unions that failed during the financial crisis would have been covered by this rule prior to failure. In effect, this is "Security Theater" – a way for the NCUA to show the outside world it's doing something.

Unfortunately, this farce isn't free. It will cost credit unions and their member-owners millions and millions of dollars to comply with and it will deflect the attention of both credit union managers and supervisors from real problems. In other words, in the end, instead of strengthening the credit union system and protecting the insurance fund, it will do the opposite.

Last year I joked that the proposed rule could not have been worse if the American Bankers Association had written it as part of its anti-credit union campaign. A year later, the irony is that banking regulators themselves are abandoning this failed model. Only the NCUA, years late, and millions of dollars too expensive, is pressing forward...into the 1980s.

Respectfully submitted,

Christopher O. Howard