April 08, 2015

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

RE: Comments on Proposed Rule: Risk-Based Capital; RIN 3133-AD77

Dear Gerald Poliquin,

Thank you for the opportunity to comment on the proposed risk-based capital rule a second time. The Utah Credit Union Association represents 70 credit unions in Utah, and approximately 1.8 million credit union members in the state.

We appreciate many of the changes implemented in the revised proposed rule. Reducing the well-capitalized requirement to 10%, delaying the implementation date, shrinking the risk weights for many types of assets, allowing the entire ALLL to be included in the ratio, and removing interest rate risk from the equation are all improvements.

Nevertheless, we feel that the rule as currently proposed will still needlessly negatively affect the ability of credit unions to serve consumers, and should be tabled or significantly modified.

Current rules and regulations are enough to ensure adequate safety and soundness

It is certainly true that credit unions should manage their risk as they serve members. In fact, operating in a safe and sound manner should be the first priority for every credit union. They should not be able to do anything they want without considering the risk. But the existing framework of NCUA's rules and regulations already covers risk adequately. The proposed risk-based capital rule—while improved—continues to be overkill because there are already enough safeguards in place.

One of the primary safeguards to the credit union industry is the NCUSIF. The proposed rule seeks to reduce risk to the insurance fund by requiring credit unions to carry more capital. We question why this is necessary. Overall, the NCUSIF weathered the recent recession well. Yes, there were losses to the fund, but insurance funds are expected to take some losses. Losses were not extreme and did not destroy credit unions that stayed healthy. This is evidence that the current system is set up well.

This system is not limited to just the insurance fund itself, but to the laws, rules, and regulations already in place and as administered by the NCUA and state regulators. All of them, combined, served credit unions well, and since the recession many of them have been shored up, making the system even stronger. This proposed rule will place the weight of all the risk on individual credit unions, negating the purpose of a shared insurance fund, and reducing its utility to a marketing tactic to make consumers feel better about depositing funds into a credit union.

An apt metaphor exists in the industry. Consider a credit union that turns away many loans because it doesn't want to have too many losses. Yet the credit union subsequently never writes off any loans. And it also keeps 20% capital—just in case things go badly. The policies and practices of the credit union are so tight that it's not able to function as a proper credit union. It's not helping people it could be helping due to over-tight practices. It could stand to loosen its guidelines, help more people, and take a few losses.

The same principles apply to this proposed regulation. It seeks to mitigate risk that the insurance fund is there to cover. If the fund is never dipped into in the future, then the regulations are too strict. And by the looks of it, this regulation is designed to force credit unions individually to carry all the risk, thereby removing it from the insurance fund.

Why does this matter? Because the more conservatively a credit union operates, the fewer consumers—within a narrower scope—it can serve. The point is not that credit unions should be able to do whatever they want without considering the risk. The point is that the current proposed rule establishes more and deeper regulations that limit institutional behavior in new ways.

How does it limit credit unions? It will prevent them from making some loans or investments because of the increased capital requirements. It will limit creativity in coming up with new solutions to old problems. The credit union is now managed to with capital as the primary concern, and member needs as a secondary concern, instead of visa versa. This restricts the credit union's ability to operate in as diverse a way as it otherwise might, and could easily restrict consumer access to some types of credit union products and services.

In the end, the cost of the rule is flexibility of credit unions to serve members in diverse ways. Credit unions will become more homogenous in their scope and operations, which prevents them from reaching into different parts of the consumer market in different ways. Consumers are hurt.

We do not feel that, considering the regulatory and examination system already in place, that the added security to the insurance fund is worth the sacrifice, just as it's not worth a credit union tightening loan policies to the point that they don't make any loans.

The fund is there to cover some risk. Credit unions should not have to bear all that risk on their balance sheets. Why bother with an insurance fund, then? At that point, the NCUSIF becomes only a formality to make consumers feel better about using a credit union. There's value in that, but it reduces the utility of the insurance fund as a safety net.

Adequate regulations are already in place to address interest rate risk

For this same reason, it was wise of NCUA to eliminate interest rate risk from the calculation of risk-based capital. In fact, NCUA's recent IRR rule from 2012 should already be adequate to ensure that credit unions manage their interest-rate risk appropriately. If a credit union is not operating within the guidelines set by that rule, they should not be penalized with an additional capital requirement, but should be penalized with actions that bring them into alignment with the 2012 guideline.

That is, the existing examination and supervisory process should already be adequate to help credit unions manage their interest rate risk.

Supplemental capital should be designed for all credit unions

Another positive sign regarding the improvement of the rule is the interest in supplemental capital. It seems that the purpose of the risk-based capital rule and ratio is to consider all of the funds available to cover a loss at the credit union. Hard dollars. Money—not accounting constructs—available to cover losses. It would stand to reason that supplemental capital counts as hard dollars available to cover losses. Therefore, supplemental capital should be included in the risk-based capital calculation.

Our Association encourages the NCUA to find ways to allow *all* credit unions to take advantage of supplemental capital. Ideally, supplemental capital would not modify the ownership structure of the credit union, but would instead allow people eligible for membership to access a broader range of investment opportunities. For example, a simple type of supplemental capital would be an uninsured term deposit that functions as capital on the credit union's balances sheet, instead of as deposits.

Naturally, any such kind of supplemental capital would require adequate disclosure to members regarding the nature of the investment, to ensure they understood that with increased potential reward comes increased risk. Access to supplemental capital would help credit unions grow to serve more consumers, and also improve the safety and soundness of credit unions by adding an additional source of capital.

The definition of complex credit unions should be more precise

Another improvement in the proposed rule is the change of the definition of complex. Raising the amount to $100 million will likely exempt from the regulation some credit unions that are not complex—a good move. We still feel, however, that a more precise method should be used.

What do we know about credit unions with $100 million in assets? One thing, and one thing alone: that it has $100 million in assets. It may or may not be complex.

Precision benefits everyone. Without a precise definition, NCUA will probably spend time in exams that it doesn't need to spend, evaluating things it doesn't need to evaluate because the credit union just isn't that complex. Likewise, it may miss out on a credit union that is complex with less than $100 million in assets (if there are any).

A precise definition will establish clear criteria related to the mix of assets and liabilities. Note that "run-of-the mill" assets and liabilities would not create a complex credit union in any mix. These would include the majority of products, such as share drafts, term deposits, most types of real estate loans, consumer loans, and relatively small, secured business loans. In addition, federally insured investments of just about any kind would not contribute to the complexity of a credit union.

Complex credit unions are involved in a large amount of unusual assets and liabilities, relative to their asset size. "Unusual" balance sheet items would include specialty mortgage products, non-federally insured investments, non-agency mortgage-backed securities, non-mortgage-related securities with embedded options, repurchase transactions, and derivatives. To be complex, a credit union would need to be involved in several of the above types of assets or liabilities, and they would need to comprise a significant portion of the balance sheet.

The most likely scenario is that a relatively small percentage of credit unions are complex. Narrowing the definition of "complex" is NCUA's best tool for creating a regulation that balances both the FCUA's requirement for a risk-based capital requirement, and the imperative to not hinder the industry's ability to help consumers. Changing the definition of complex may be the best way to prevent the rule from needlessly hurting consumers and credit unions.

At the least, if asset size is used as a marker for complex, it should be at $10 billion or higher to ensure that no credit unions that aren't complex are affected by the rule. But even then, just using an asset size still over-simplifies the notion of complexity, and risks covering credit unions that aren't complex.

Capital adequacy should be clearly outlined and defined in regulations

Another opportunity for significant positive change in the proposed rule is the capital adequacy requirement. While improved from the first proposal, that examiners and NCUA could subjectively impose different capital requirements on a credit union subverts the entire body of rules, regulations, and examination procedures.

By saying it may need to impose more capital requirements, NCUA is basically saying that all of the tools already in place may be in adequate to ensure that all credit unions and the share insurance fund can adequately handle the risk in the system. This is not the case, as already evidenced by credit union and share insurance fund performance during the recent recession. If the existing system were insufficient, we would have seen far more credit unions failing during the recession. We might have seen the NCUSIF become insolvent. But we saw neither.

Additionally, as we talk with credit unions after their exams, many of them comment about how examiners want them to put everything on paper. Nothing should be in the president's head. There is no managing based on gut feelings or years of subjective experience. Examiners want policies, procedures, and calculations to prove everything and to justify every decision made.

Yet, by retaining the right to require a credit union to have more capital based on no pre-established criteria, NCUA is proposed to keep for itself what it denies credit unions—the ability to subjectively make a determination.

The only scenario under which it would not be completely outrageous for NCUA to claim this power would be if it established clear criteria under which it would require a credit union to have more capital. And if such a situation could be envisioned, perhaps it should be part of the risk-based capital rule.

At the point when NCUA can determine beyond the scope of any established rules and procedures that a credit union does not have adequate capital, all other capital requirements cease to have meaning and a credit union can never have enough capital. “More is always better” becomes the rule. And as credit unions seek more, this hurts members as the credit union retains more of its earnings.

Summary

Thank you for the opportunity to comment again on the risk-based capital proposal. It is much improved over the previous rule, but continues to need modification. The best way to minimize the negative impact of the rule is the define “complex” with more precision.

Sincerely,

Stephen Nelson
VP-Credit Union Support
Utah Credit Union Association

cc: CUNA, CCUL