National Credit Union Administration

Office of the Chairman

May 30, 2014

The Honorable Peter King
Member of Congress
339 Cannon House Office Building
Washington, DC 20515

Dear Congressman King:

Thank you for your letter about NCUA's proposed rule to modernize the agency's risk-based capital regulation for federally insured credit unions. The NCUA Board welcomes your views on this important issue. As we are reviewing the comment letters, we are committed to carefully considering the concerns of all stakeholders and making needed adjustments to the proposal before adopting a final rule.

Need for Rulemaking

In January, the NCUA Board proposed a regulation updating the agency's risk-based capital requirements, which have not changed since adoption in 2000. Several factors compelled the NCUA Board to modernize the rule: lessons learned during the recent financial crisis, the adoption of new Basel capital accords, recommendations of the Government Accountability Office (GAO) and NCUA's Inspector General, and the issuance last year of new risk-based capital rules by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve.

With the risk-based capital proposed rule, our goal is to ensure that those federally insured credit unions that have a higher appetite for risk hold enough capital to match that risk. In other words, the proposal seeks to scale the capital requirements based on an individual credit union's balance sheet risks. The proposed rule is similar to the risk-based capital rules for other U.S. financial institutions and provides the flexibility envisioned in the Basel capital accords.

Ensuring that credit unions hold sufficient capital to withstand reasonable economic shocks is fundamental to ensuring the safety and soundness of the credit union system. Sufficient capital at each federally insured credit union, combined with the strength of the National Credit Union Share Insurance Fund, will protect 97.1 million credit union members from losses and contribute to the overall stability of the economy.

Further, the NCUA Board both understands and shares the policy objective referenced in your letter of ensuring continued prudent lending to support the economy. Accordingly, the NCUA Board will remain mindful in its deliberations of the trade-offs between the costs and benefits of the regulation, so credit remains available for consumers, homebuyers, and small businesses.

Calculation of Risk Weights

As your letter recognizes, the proposed rule is more calibrated to risk than NCUA's existing rule. NCUA developed the proposed risk weights based on the Federal Credit Union Act's requirements, available credit union data, and comparability to the risk-based capital system for banks. By law, NCUA must adopt a risk-based capital rule that is comparable to the rules for banks[1] but that also takes into account <u>any</u> material risks to credit unions,[2] such as interest rate risk and concentration risk in addition to credit risk.

While striving for overall comparability with the FDIC's rule, NCUA has proposed several different risk weights, consistent with the law, such as a lower weight of 75 percent for credit unions' consumer loans in comparison to the banking system's risk weight of 100 percent. NCUA also proposed retaining the tiered risk-weight approach from our existing rule to account for higher concentrations in member business loans and mortgage loans. A 2012 report by the GAO specifically recommended NCUA address such concentration risk. Similarly, NCUA proposed maintaining tiered risk weights for longer-term investments in order to account for interest rate risk.

Please be assured, as part of the rulemaking process, the NCUA Board will carefully consider the comments received when determining how best to calibrate the final risk weights, including any comments received about the risk weights for real estate loans, agricultural loans, and member business loans. The stakeholder feedback will help to inform us in determining the most appropriate risk weight for each asset type. Further, when issuing the final rule, we will provide further clarity in response to comments as to how NCUA calculated certain risk weights and why those risk weights may, in some instances, differ from the risk weights for federally insured banks.

Cost Impact of Proposed Rule

I am very concerned about the dissemination of misinformation about the costs of the proposed rule. Some trade associations have estimated that the implementation costs could run as high as $7 billion. These overstated figures are based on a questionable assumption that every federally insured credit union would seek to maintain its current capital cushion above the regulatory minimum.

In reality, the decision whether to hold a capital cushion and how large that should be is a business decision that each credit union makes. I emphasize that the proposed rule does not require credit unions to maintain <u>any</u> specific capital cushion above the regulatory minimum standard for being well-capitalized.

Additionally, the measure of an individual credit union's capital adequacy should not be based upon maintaining a targeted dollar amount above the regulatory minimum. Proper capital

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[1] 12 USC 1790d(b)(1)(A)(ii)
[2] 12 USC 1790d(d)(2)

adequacy measurement should be much more granular and based on each credit union's strategic plan and risk profile.

Under NCUA's proposed rule, the overwhelming majority of credit unions would experience no change in their assigned prompt corrective action category. Overall, the proposed rule would only apply to federally insured credit unions with assets of $50 million or more—2,200 out of about 6,600. As a result, the 4,400 federally insured credit unions below $50 million in assets—two thirds of all credit unions—are not affected by the proposed rule. No small credit union's capital requirement would be affected by the new rule.

Of the 2,200 credit unions subject to the rule as proposed, nearly half would actually see an improvement in their capital levels relative to their risks. Additionally, because the overwhelming majority of these 2,200 credit unions would experience no change in their prompt corrective action category under NCUA's proposed rule, the rule would not require them to raise any additional capital. Under the proposed rule and using December 2013 data, 92 percent of all federally insured credit unions would remain well capitalized, 5 percent of credit unions that are currently undercapitalized would remain so, and only 3 percent of credit unions would see a reduction in their prompt corrective action category because of the proposed rule.

Collectively, only 201 federally insured credit unions comprise the 3 percent affected by the proposed rule. NCUA estimates these credit unions would need to add a collective total of about $633 million in additional capital (equivalent to 0.8 percent of their combined assets of $80 billion)—but only if all 201 choose to maintain their balance sheets' current risk exposure. Alternatively, without raising any more capital, these affected credit unions could reduce their risk-weighted assets; or they could choose a combination of these two strategies.

To address the concerns of credit unions about access to capital, Congress may want to consider H.R. 719, the Capital Access for Small Businesses and Jobs Act. This legislation would provide all federally insured credit unions with an additional tool to promote sufficient capital stability, even under adverse economic conditions, similar to the authority Congress granted to low-income credit unions.

Comment Period

Your letter also asked NCUA to extend the comment period. Initially, the NCUA Board had planned on a 90-day comment period to allow more time than the standard comment period of 30 or 60 days. Ultimately, from the time the NCUA Board issued the proposed rule on January 23 until the close of the comment period on May 28, commenters had 125 days to review the proposed rule. In all, the comment period was NCUA's second longest in the last two decades and provided ample time for stakeholders to review and provide useful comments.

The volume and depth of the letters we received, some as long as 47 pages, indicate a thoughtful and considered review of all relevant issues. Before finalizing our revised rule on risk-based capital, we plan to carefully analyze and evaluate every comment received.

Also, to further the discussion on the proposed rule, I will be holding three listening sessions, so credit union officials can offer their suggestions in person prior to the rule being finalized. NCUA Board Member Rick Metsger will be joining me at the listening sessions. These sessions will be held in June and July in Los Angeles, Chicago, and Alexandria.

Timeframe for Implementation

I share your concern about the adequacy of the implementation timeframe, and I assure you that the NCUA Board will re-evaluate the amount of time needed before the final rule goes into effect. We recognize that it will take time for the affected credit unions to amend their risk polices and adjust their balance sheet strategies to comply with the revised regulation. During that same time, NCUA will need to change quarterly data collection procedures to address changes contained in the final rule.

The NCUA Board is fully committed to making changes and clarifications, where warranted, based on the comments received to produce good public policy. Stakeholder comments, as well as your thoughtful letter, will help us to improve our final rule.

Please do not hesitate to contact me about any questions or concerns you may have, or your staff may contact Todd Harper or Al Garesché in NCUA's legislative affairs office at 703-518-6330.

Sincerely,

Debbie Matz

Debbie Matz
Chairman