Open Board Meeting Jan. 15, 2015

NCUA Vice Chairman Rick Metsger
Statement on the Proposed Risk-based Capital Rule

Thank you Chairman Matz.

This is the longest, most complicated, and most important rule we have considered since I joined the Board 15 months ago.

I want to begin by thanking the staff, especially Larry Fazio and the Office of Examination & Insurance team, and Mike McKenna and the Office of General Counsel team, for the countless hours they spent preparing this rule, its predecessor, and reading the more than 2,000 comments we received on the first rule.

I also want to thank the credit union community for their thoughtful comments, both in formal comment letters, in our three nationwide listening sessions, and in dozens of other meetings I have had with them since the first proposed rule was released almost a year ago.

When people review this rule, they will find that we took their comments seriously and made substantive changes, even though a strict construction of the Administrative Procedure Act would have allowed us to not respond to those comments in this document because this is a new proposed rule. We read those comments, and are responding to them, not because it is required, but because it is the right thing to do. We are following the spirit of the law, even if the letter of the law does not require us to do so.

Second, I want to note that when I joined the board, over a year ago, I inquired why our board meetings were not streamed live to the public. I was informed that while we do post videos on our web site after a meeting is over there were technical challenges to live streaming but that the Agency was looking into that option.

After last month's board meeting, I asked for a status report on streaming and indicated my strong preference to have streaming available in time for whatever meeting we considered a new RBC rule.

While staff has started testing live streaming, I regret it is not yet available. Staff believes it will be another couple of months before we have the equipment and technology to do live streaming, especially with the closed captioning we are required to provide to comply with our commitment to meet the needs of people with disabilities.

I want to thank the Chairman for her commitment to improving our technology so we can do live streaming, and by opening-up our meeting today to video cameras. While I doubt we will win any Emmys, I do believe this will be a service to the public.

If there is a message from today's meeting it is that we have listened and have produced a proposed rule which appropriately balances safety and soundness with requirements that would be placed on certain credit unions.

The rule may not be perfect, and I would emphasize that it is, as many requested, just a proposed rule, which everyone can comment on, and not a final rule. In a rule this long it is likely we can continue to make improvements, and that is why we invite further comment on it. But it is a good rule and holds up well when viewed alongside our existing rule, the last proposed rule, or the considerably longer and more complicated RBC rules issued by other financial regulators.

In fact, as we invite comments on this proposed rule, I invite people to comment on whether we have gone too far and provided too much leniency, too much flexibility, and too long a transition period. It is possible the pendulum has swung too far and needs to swing back a little in the final rule.

I intend to support issuing this proposed rule for comment today, because I believe our current RBC rules are inadequate and this proposed rule does a much better job of fulfilling our statutory responsibility to have a rule which is comparable to, and equivalent in rigor to, the rules of other banking regulatory agencies, even if it is not precisely identical because it takes into account the unique nature of credit unions.

Why do I feel we have achieved a fair balance? Because the proposed rule exempts nearly 80 percent of credit unions, but it covers approximately 90 percent of the assets insured by the Share Insurance Fund. What we have is maximum coverage and minimal burden.

And to those who suggest that the burden of a credit union charter and NCUSIF insurance is too great and they would be better off as banks, I would remind them that in addition to changing their tax status, the risk-based capital rules for banks are more complex and burdensome, and contain no, let me repeat no, exemption for small banks. Every bank, no matter how small, must comply with RBC for banks, while under this proposed rule nearly 80 percent of credit unions are exempt.

It has taken a full year to produce a new RBC rule largely because we have listened to the more than 2,000 comment letters we received, to the hundreds of comments at our three national listening sessions, and to the hundreds if not thousands of comments the board members received in meetings with state leagues and individual credit unions.

How have we listened? Let me list just a few ways:

- We started with a longer than normal 90-day comment period almost a year ago.
- We are giving everyone a second formal opportunity for comment by issuing a new rule today with a new 90 day comment period. We have revised the

definition of "complex" in a way that doubles the size of the exemption for small, non-complex, credit unions from $50 million in assets to $100 million.

- We have removed Interest Rate Risk from this rule. As a result we are no longer trying to measure IRR and credit risk with a single rule.
- We have clarified that individual examiners cannot set risk based capital levels and taken-out the entire Individual Minimum Capital Requirement (IMCR) section.
- We have more than doubled the length of the implementation period, even though the rule is simpler and will affect far fewer credit unions.
- We have cut in half the number of concentration levels for both MBL and mortgages. The remaining concentration limits will impact only a small number of true outliers, those that are at least two, and in some cases as many as five standard deviations beyond credit union averages.
- We have allowed credit unions to count their entire Allowance for Loan and Lease Losses (ALLL) rather than capping it at 1.25 percent of assets.
- We have increased by 50 percent the definition of what constitutes a "current" loan, from 60 days to 90 days. This is a significant positive change for credit unions and brings our definition of "current" in line with the other banking regulatory agencies.
- We have reduced the risk weight for investments in CUSOs by 40 percent from 250 percent to 150 percent and for loans to CUSOs by one-third from 150 percent to 100 percent. In addition, a wholly-owned CUSO can consolidate itself under GAAP, resulting in no separate capital charge for the CUSO.
- Risk weights are now more comparable to the risk weights in the bank RBC rule, and where there are differences, as there is for consumer loans, they are generally lower for credit unions because of their lower risk profile. Seventy-eight percent of covered credit union assets will have risk weights identical to their bank counterparts, 19 percent will have lower risk weights, and less than 2 percent will have higher risk weights.
- We have added a ten-year phase-in for supervisory goodwill.

Have we agreed to every single request? No, because after careful analysis, some of them did not make sense. Others conflicted with one another. But we have made a good faith effort to enact an evidence-based rule. And where we disagreed, we explained why, which is why the preamble to the rule is so long.

But to those who complain it is too long and too complicated, I invite you to read the comparable rules for banks.

There is an old adage that when the facts are not on your side, you argue the law, and when the law is not on your side, you argue the facts. And when both the facts and the law are not on your side, you argue the process.

We are likely to hear complaints about the process the Agency has used to propose this rule, our authority to issue parts of it, and the rigor of our cost-benefit analysis.

These are all "red-herrings," side shows and diversions to distract attention from the fact that we have listened and this is a good rule.

I'd like to address these red-herrings one at a time.

First, with regard to process, I would note that it has been very deliberate. The first proposed rule was issued a year ago, we are having a new 90 day comment period on a new rule now, a final rule is unlikely to be issued until late this year, and will not take effect until January 2019, or five full years after this process began.

Everyone will have had two opportunities to comment, and plenty of time to do so. They will have had opportunities to participate in Listening Sessions around the country and an online webinar, and will have had access to summaries, FAQs, lengthy preambles addressing questions submitted during the comment periods, and an RBC estimator so they can evaluate the impact of the proposed rule on their credit union.

The argument that we haven't had enough time to review this rule is laughable, both because the topic has been under consideration for a year, and because it isn't even done yet. We are still in mid-process and people have additional opportunities to comment and make suggestions for improvement.

This wasn't just dumped on us this week, or even two weeks ago. It has been under active consideration for a year. Staff has provided board members with multiple briefings on our existing rule, the first proposed rule, this second proposed rule, and individual components of each rule.

Where board members chose to do so, it has also been an iterative dialogue. We have had opportunities to brief staff on our thoughts on the issues before us, and to ask questions which they responded to.

Staff prepared for us about 1,000 pages of white papers on more than 20 separate issues from the Allowance for Loan and Lease Losses to Supplemental Capital. I know my office started receiving these white papers from Larry and his team in November and has had them for about two months.

Each white paper had a dozen or more sections including:

- A summary discussion of options and a recommendation.
- A summary of possible changes that will be needed in CALL reports to implement the proposal.
- An analysis of legal issues and NCUA's authority.

- An analysis of accounting issues.
- An analysis of applicable sections of the Federal Credit Union Act.
- An analysis of how the issue is handled under the Basel accords.
- An analysis of the FDIC's rule in the same area.
- An analysis of the proposal's costs and benefits on credit unions. And I would note that while Larry indicated that the cumulative cost is about $5 million, this is not the cost per credit union. The average cost per credit union is $1,276 for complex credit unions and $638 for non-complex credit unions.
- An analysis of options.
- An analysis of comments received on the issue.
- An analysis of State Supervisory Agencies' concerns.
- Additional background information including:
  - An analysis of the current NCUA rule.
  - The proposed rule language.
  - GAO recommendations.
  - NCUA IG recommendations and analysis of Material Loss Reviews.

These reviews were very helpful to me and my staff. For the last two months my Senior Policy Advisor has provided several hundred detailed thoughts, comments and questions, in as transparent a process as possible, to the other two Senior Policy Advisors and to appropriate Agency staff.

I want to thank Chairman Matz's Chief of Staff and Senior Policy Advisor Steve Bosack for being similarly transparent. I also want to thank Larry and other Agency staff for responding to those concerns. I can see that these thoughts, comments, and questions have been addressed in the latest draft rule and have hopefully improved it.

Staff has been fully responsive, and my office has been provided the time we need to consider each issue.

After we completed our review of the white papers in November and early December, we received a draft rule and preamble in late December, which we were able to review quickly because we were familiar with just about everything in it due to the work we had done on the first rule and the white papers.

Nonetheless we had nearly 100 questions, concerns, and recommended improvements in the preamble and the rule which we went over with Larry Fazio of E&I, Lara Rodriguez of OGC, and several other staff. We resolved each of these issues to our mutual satisfaction, and I know that each of the other board offices was given a similar opportunity.

The comments received during this iteration are what produced the latest draft of the preamble and rule this week.

I can say for my part that throughout this process my staff has been as transparent as possible with Agency staff and with the staff of the other board offices.

Second, with regard to the Agency's statutory authority to issue this proposed rule, I would begin by noting that we have a statutory obligation, as well as the authority, to issue an RBC rule.

We would not be doing our job as regulators if we did not issue an RBC rule that protects the safety and soundness of the NCUSIF, as well as the roughly one Trillion dollars American consumers have on deposit at federally-insured credit unions. We have a duty to protect against, "any material risks" and to design a system which is "comparable to" the FDIC's RBC system.

A number of people have attempted to take one clause of the Credit Union Membership Access Act out of context, to ignore other language in the Act, and to misapply the courts' rulings in Chevron and related cases to contend that the NCUA does not have the authority to issue separate capital requirements for "well" and "adequately" capitalized credit unions.

I disagree, as does our Office of General Counsel.

Both "well" and "adequately" capitalized credit unions are required to meet "any applicable risk-based net worth requirement." Under the Chevron standard that requirement can contain multiple parts and under the Credit Union Membership Access Act it must be comparable to the FDIC's RBC requirement.

Our rule will not be comparable to the FDIC's rule or, "parallel in substance," if the FDIC has separate RBC levels for "well" and "adequate" and we do not.

I would further note that the FDIC rule also refers to a risk based capital requirement in the singular, but has separate levels for "well" and "adequately" capitalized banks.

The reference in Section 216(d)(2) of the Credit Union Membership Access Act to designing "the risk-based net worth requirement to take into account any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection" provides a floor, but not a ceiling on RBC and does not preclude separate RBC levels for "well" and "adequately" capitalized credit unions.

Common sense tells you that if a credit union voluntarily chooses to meet a higher "well-capitalized" RBC standard it is less likely to fall below "adequately-capitalized."

The purpose of Prompt Corrective Action and RBC is to reduce risk to the fund. That is what separate RBC levels do. This is neither "arbitrary" nor "capricious," it is a reasonable and permissible interpretation of the statute allowable under the Chevron doctrine.

Notwithstanding attempts to re-write history by individuals who are now affiliated with entities that receive hundreds of thousands of dollars lobbying for credit unions, I believe both our authority, and our obligation, to act are clear.

Third and finally, I would like to address cost benefit analysis. As I indicated up front, this rule exempts nearly 80 percent of credit unions while covering approximately 90 percent of insured deposits.

Furthermore, only 19 out of more than 6,000 credit unions, or less than one-third of one percent of all credit unions, would have their PCA categories reduced as a result of this adoption of this rule. Those credit unions would either have to raise, in aggregate, about 50 million dollars in additional capital, which they would have another three to four years to do, or make compensating adjustments to reduce the risk of their balance sheets in order to remain “well-capitalized.” All but one of them have the option of just allowing their PCA category to drop from “well-capitalized” to “adequately-capitalized.”

In addition to the fact that this roughly $50 million impact on a trillion dollar plus system will be spread-out over 3-4 years, the cost will be more than offset by a projected decline in losses to the Share Insurance Fund.

In conclusion, I want to simply note that the existing system is broke, and does need to be fixed. Our current RBC rule requires only two credit unions to hold more capital than they are required to hold under the leverage ratio. In addition, of the 27 credit unions that failed during the Great Recession only two were considered less than well capitalized under the existing rule.

Yet these 27 failed credit unions cumulatively cost the Share Insurance Fund $728 million, costs that were borne by other credit unions which took less risk and were better capitalized. It is for the remaining 6,000 plus well-run credit unions, and their members, that we take this action today.