Comment Letter Guide

Comments on NCUA's revised proposal on Risk-Based Capital (RBC2) are due by April 27, 2015. Although RBC2 is substantially improved from last year's original proposal (RBC1), there remain a number of areas that should be improved. Thoughtful comment letters from credit unions outlining their concerns are the best way to insure the necessary improvements are made. This guide provides some suggestions on how to develop and submit your comment letter and lists a number of issues you may wish to address. CUNA strongly urges all credit unions to comment on the proposal.

Before drafting your comment letter, refer to CUNA's Risk-Based Capital Action Center which provides information to help your understanding and analysis of the effect the proposal will have on your credit union. You'll find estimates of your credit union's RBC ratios, a calculator to provide a more precise measure of your RBC ratio, and explanations of the proposal.

Your comment letter should begin with your general thoughts on the overall proposal, followed by a more specific discussion of the particular issues that concern your credit union. Listed below are a number of issues you may wish to cover in your letter. For a more detailed analysis and explanation of these issues, see CUNA's detailed summary.

A letter in your own words expressing your main views on the proposal will be most effective. It is not necessary to comment on every aspect of the proposal. Instead, focus on the issues of greatest concern to you. For examples of content and style, you can see any of the letters that have already been submitted to NCUA here and CUNA's RBC1 comment letter.

Issues to Consider for Inclusion in Your Letter

Need for the Rule

NCUA's justifications for proposing a new risk-based capital rule are: to make the RBC system for credit unions more comparable to bank RBC requirements, to respond to GAO recommendations, and to require credit unions that take more risk on their balance sheets to hold more capital to minimize losses to the share insurance fund.

CUNA's Position: The risk-based capital proposal is a solution in search of a problem. Given the very strong performance of natural person credit unions and the NCUSIF during the recent financial crisis and Great Recession, especially compared to banks and the FDIC, there is no evidence that credit unions were undercapitalized, or that had RBC2 been in effect, that there would have been any material reduction in insurance losses to the NCUSIF. Further, although the Federal Credit Union Act (FCUA) directs the NCUA to devise a risk-based capital requirement that is comparable to the system in effect for banks, the FCUA also requires NCUA to take account of the unique nature of credit unions. We believe the RBC2 proposal goes way too far to address the first of these goals, at the expense of the second.

Issues to Consider:

- Is the proposed system even needed?
- Is it realistic or desirable to have a RBC system that would avoid virtually all losses to the share insurance fund even in a very severe financial crisis?
- Are the costs to the credit union system of implementing the proposal worth the potential benefits?

Risk Weights

Improving risk weights was a primary objective of CUNA's to improve a possible RBC rule, and there have been a number of changes.

Changes from RBC1 to RBC2: NCUA has improved the risk weights for RBC2. NCUA's chart lists the proposed risk weights compared to those in RBC1, and those to which banks are subject. In particular, the risk weights for higher concentrations of mortgage loans and business loans have been reduced, but the risk weights for CUSO investments and mortgage servicing assets remain high.

CUNA's Position: NCUA made many positive changes to the risk weightings; however, the risk weights for CUSO investments and mortgage servicing rights remain too high and could affect a credit unions' ability to own and operate CUSOs and hold mortgage servicing rights.

Issues to Consider:

- Are the risk weights for CUSO investments (150%) and mortgage servicing assets (250%) too high?
- Do you agree with the changes to the other risk weightings? Has NCUA reduced risk weightings enough?
- Should credit union risk weightings be similar to those for banks?

Goodwill

RBC2 permits goodwill in "supervisory" mergers to be included in the RBC numerator until 2025, but other forms of goodwill remain excluded.

Changes from RBC1 to RBC2: In general, the RBC1 and RBC2 would require the subtraction of goodwill from capital in the RBC ratio. RBC2 would allow a credit union to include "supervisory" goodwill as part of capital, but this provision would expire in January 2025. The agency has defined a "supervisory merger" in a positive way to include mergers in which the agency or a state regulator has identified the continuing credit union even if no actual assistance for the merger was required. CUNA supports this definition. Some credit unions engaged in mergers with troubled credit unions during the recent financial crisis as a way to reduce insurance losses to the NCUSIF. Some of these credit unions would be harmed if they were no longer permitted to include this supervisory goodwill after 2024.

CUNA's Position: CUNA's position remains that goodwill should not be immediately deducted from the numerator of the risk-based capital ratio. If deducted, the deduction should be phased out over a ten-year period. Further, goodwill arising from previous supervisory mergers should be grandfathered and allowed to be counted as risk-based capital without a time limit so long as it meets GAAP requirements. Credit unions that supported NCUA's programs to minimize losses to the NCUSIF in the financial crisis should not be penalized by a change in the rules after the fact.

Issues to Consider:

- Goodwill is only permitted to be added to the numerator for the risk-based capital ratio for "supervisory" mergers and only until 2025.
- Should other goodwill be immediately deducted from the numerator of the risk-based capital ratio, or should it be phased in over a period of time?
- Should goodwill arising from past supervisory mergers during and following the financial crisis, which likely reduced insurance losses to the NCUSIF, be grandfathered indefinitely?
- RBC2's treatment of goodwill could affect further business decisions because of its unfavorable treatment.

Interest Rate Risk

Interest rate risk (IRR) rules are not included in RBC2; however, NCUA asks specific questions on how the agency should address IRR.

Changes from RBC1 to RBC2. One of the most substantial changes in RBC2 was to eliminate higher risk weights for longer-term investments. However, NCUA intends to issue a new proposal on interest rate risk that would apply a minimum quantitative measure of interest rate risk to all covered credit unions using some common measurement framework. This would be in addition to the Interest Rate Risk Policy and Program rule adopted in 2012. NCUA has asked credit unions to provide their specific views on how IRR should be addressed in the context of prompt corrective action.

CUNA's Position. Interest rate risk should not be incorporated into the risk-based capital system, or in any way grafted onto the Prompt Corrective Action system. NCUA already has an interest rate risk rule in place that provides adequate protection. The measurement and management of interest rate risk is more an art than a science. There is more than one way to evaluate interest rate risk, and selecting just one in a fixed rule would unnecessarily restrain credit union risk-management. If NCUA feels that additional interest rate risk steps are needed, they should be addressed in the regulatory, examination, and supervision process.

Issues to Consider:

- Should IRR be handled by NCUA through rulemaking or through the supervisory process with guidance?
- Are additional IRR requirements necessary?
- If NCUA were to propose a new IRR rule, what methods of interest rate risk measurement should be included?

Complex Credit Union Definition

The RBC rule only applies to a "complex" credit union as defined by NCUA.

Changes from RBC1 to RBC2: RBC1 defines any federally insured credit union with more than $50 million in assets as complex. RBC2 would increase this threshold to $100 million.

CUNA's position: CUNA has concerns with the approach of defining credit unions as complex simply based on asset size. NCUA should define complex with factors such as deposit account types, member services, loan and investment types, and portfolio composition. We feel this approach is more consistent with the Federal Credit Union Act which requires NCUA to consider "the portfolio of assets and liabilities" of credit unions when determining whether they are "complex."

Issues to Consider:

- Should the asset threshold be indexed so that it does not apply to smaller and smaller credit unions through time due to inflation?
- Should the threshold for a "complex" credit union be set at some number greater than $100 million?
- Why a credit union with more than $100 million in assets is not necessarily complex.
- What number of complex products and services should a credit union be allowed to engage in before being designated as "complex," and why?

Supplemental Capital

The proposal does not permit the use of supplemental capital for RBC purposes, beyond the existing ability of low-income designated credit unions to count supplemental capital as net worth. However, NCUA is seeking comments on how that could be accomplished.

Changes from RBC1 to RBC2: RBC1 did not address supplemental capital. CUNA argued in our comment letter and a separate legal opinion that NCUA had the authority to at least allow supplemental capital to be included for RBC in the RBC numerator.

CUNA's Position: CUNA supports the inclusion of supplemental capital by credit unions in the RBC numerator. Although current law may not permit the use of supplemental capital as net worth, NCUA can and should authorize supplemental capital's use for RBC.

Issues to Consider:

- Can or should additional forms of supplemental capital be included in the risk-based capital ratio numerator?
- What specific criteria should such additional forms of capital reasonably be required to meet to be consistent with GAAP and the Federal Credit Union Act?
- What investor suitability, consumer protection, and disclosure requirements should be put in place related to additional forms of supplemental capital?

Capital Adequacy

RBC2 would require a credit union to hold capital commensurate with its risks, "notwithstanding the requirements" of RBC2 and PCA net worth requirements. This would allow a credit union examiner to consider a credit union's internal desired capital assessment and planning as a standard for examination and supervision.

Changes from RBC1 to RBC2: NCUA has eliminated the provision in RBC1 requiring individual minimum capital requirements (IMCR). Under the RBC1 proposal, an examiner could impose additional capital requirements on credit unions on a case-by-case basis. RBC2 would continue the authority of the NCUA Board to reclassify a credit union and if deemed below adequately capitalized, subject the credit union to supervisory actions because of safety and soundness.

RBC2 would also add a requirement that a "complex" credit union maintain capital commensurate with the level and nature of all its risks, and have a process to determine its capital adequacy in light of its risk, as well as develop a comprehensive written strategy to maintain "an appropriate level of capital."

CUNA's Position: CUNA strongly opposes the capital adequacy plan requirements in RBC2. Strategic capital planning is very important for credit unions, and each credit union's long-term desired capital ratio will depend on the credit union's own assessment of the risks it faces, and it's tolerance for risk. Such a plan should not be the subject of examination and supervision, and the goals a credit union establishes for its own capital sufficiency should not become targets or standards in an examination.

Issues to Consider:

- Capital adequacy could potentially subject credit unions to higher capital requirements than what are specifically required by the regulation.
- Similar to IMCR in RBC1, capital adequacy could enable examiners to continually demand additional capital when all other requirements of the rule are met.
- Capital strategies (the plan) to balance their risks would be subject to examiner review.
- Does NCUA have sufficient justification to require additional capital planning requirements from credit unions above what is required by RBC2 specifically?

How to Submit a Comment Letter

NCUA's comment letter deadline is April 27, 2015. Your credit union can submit a comment letter using Power Comment, which will automatically format and send your comment letter to NCUA.

NCUA also details several methods for sending comment letters to the agency. To ensure lack of confusion please put "Comments on Proposed Rule: Risk-Based Capital" in the subject line of your email and letter.

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments. Use RIN 3133-AD77
- NCUA Web Site: http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include "[Your name] – Comments on Proposed Rule: Risk-Based Capital" in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Gerard Poliquin, Secretary of the Board, National Credit Union 1775 Duke Street, Alexandria, Virginia 22314– 3428.

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