Cooperative Credit Union Association
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June 27, 2018

The Honorable J. Mark McWatters
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Risk-Based Capital

BY EMAIL ONLY

Dear Chairman McWatters:

On behalf of the Cooperative Credit Union Association, the Maryland/DC Credit Union Association, and their member credit unions, please accept this letter relative to the National Credit Union Administration's ("NCUA") risk-based capital rule ("RBC"). We urge the NCUA to delay implementation of the risk-based capital rule and raise the threshold for complex credit unions to $500 million.

I. Background

The Federal Credit Union Act mandates that the Board shall take prompt corrective action to resolve problems of insured credit unions at the least possible long-term loss to the National Credit Union Share Insurance Fund. To effectuate this mandate, the Act requires regulations to be promulgated which prescribe a system of prompt corrective action. Net worth categories and ratios are defined by the Act. A credit union's capital classification is a function of its net worth ratio and its risk-based net worth requirement.[1]

The Act states that regulations shall include a risk-based net worth requirement for insured credit unions that are complex, as that term is defined by the Board based on the portfolios of assets and liabilities of credit unions.[2] The Board is to design 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.[3]

In order to implement the statutory requirements of the Act, at its January 2014 meeting the Board issued the first risk-based capital proposal ("RBC1"). In response to the over 2,000 comments received on the

[1] 12 U.S.C. 1490(a)-(c).
[2] 12 U.S.C. 1490(d)(1).
[3] 12 U.S.C. 1490(d)(2).

original proposal, many of which were submitted by the parties, the Board determined that it was appropriate to issue a second, revised proposed rule ("RBC2").

The parties submit this request based on concerns with the second statutory prong relative to the Board's design of the risk-based net worth requirement. It is our position that the risk-based capital rule as proposed by the Board does not meet the statutory standard, as the current prompt corrective action system provides adequate protection. As a result, the risk-based capital rule should be delayed. Additionally, the threshold for a "complex credit union" should be raised to $500 million.

II. Request for Rule Implementation Delay

The impact of a new rule on risk-based capital cannot be overstated. While the NCUA made attempts to simplify aspects of the rule, any risk-based capital rule that is released will be complex. What is more, an RBC regulation will impact all levels of a credit union's operations. While other regulations may only impact a specific area of a credit union, risk-based capital considerations take place from top to bottom. Therefore, many more individuals within each credit union must have a firm understanding of the requirements under the rule. Accordingly, the parties request that the NCUA take immediate action to further delay the implementation of the rule for the reasons set forth below.

A. Credit Union Industry is Healthy

It is without question that the credit union industry is strong, and has shown consistent, traceable health and growth. The financial strength of credit unions across the country speaks clearly. Nationally, credit unions in the United States maintained 11.0% capital, with 0.81% delinquency. Median asset growth over the year ending in the first quarter of 2018 was 2.2 percent, while median growth in shares and deposits over the year ending in the first quarter of 2018 was 2.1 percent, and the median growth rate in loans outstanding was 5.0 percent over the year ending in the first quarter of 2018. At the end of the first quarter of 2018, the median total delinquency rate among federally insured credit unions was 60 basis points, compared to 63 basis points in the first quarter of 2017. Nationally, the loans-to-shares ratio was 64 percent at the end of the first quarter of 2018, and the median annualized return on average assets at federally insured credit unions was 48 basis points during the first quarter of 2018, compared to 32 basis points during the first quarter of 2017. 83 percent of federally insured credit unions had positive net income during the first quarter of 2018.[4]

It is unquestioned that credit unions possess a lower risk profile, and the current prompt corrective active system has served the credit union industry well. While the impact of capital levels remains universally strong under an RBC analysis, the parties note that many business portfolios, plans for growth, and strategic vision will change as a result of the proposal. Therefore, it remains our position that the implementation of the risk-based capital rule will have a chilling impact on the industry and the pursuit of its mission. As NCUA has publicly stated on numerous occasions, credit unions operate in the best interests of their members. Credit unions often make loans that other financial institutions either have no interest in, or, of particular note, decline to make. Credit unions continue, especially in

[4] National Credit Union Administration U.S. Map Review, First Quarter 2018, available at https://www.ncua.gov/analysis/Pages/industry/quarterly-map-review-first-quarter-2018.pdf.

gateway communities, to fill the void left by others. The parties' members have made it clear that the risk-based capital rule has the potential to constrain their ability to make these loans in their communities, thereby further diminishing the options members of the community have.

B. Recommended Implementation Delay

As proposed, the RBC rule contains a delayed compliance date of January 1, 2019. Credit unions have and will continue to diligently work to meet that timeline. However, that date does not provide sufficient time, and the parties recommend that RBC implementation be delayed beyond 2019.

Recent legislative action is reflective of the sentiment that implementation delay is necessary. H.R. 5288, the *Common Sense Credit Union Capital Relief Act of 2018*, contains provisions delaying the rule from taking effect for two years, moving the implementation date from January 1, 2019 to January 1, 2021. Additionally, just this month the House Appropriations Committee, led by Chairman Rodney Frelinghuysen (R-NJ), voted to approve the 2019 Financial Services and General Government Appropriations bill. Title IX, Section 938 of the bill includes the provisions of H.R. 5288, and would delay implementation of the RBC rule to 2021. Lastly, RBC delay provisions were also raised during a hearing on Legislative Proposals to Increase Access to Capital before the Senate Committee on Banking, Housing, and Urban Affairs. The agency should be encouraged by such legislative efforts and emboldened to effectuate a much-needed delay.

At the very least, due to the significant changes a credit union will face and the time it will take to readjust to the new rule, a five (5) to seven (7) year timeframe would be appropriate. The timeframe should be significant enough for each credit union affected by the rule to have an opportunity to adopt a plan for the NCUA's review and approval. In addition, in light of the health of the credit union system, the NCUA can afford to provide more time, on a reasonable basis, that will facilitate the development of its own examination resources and training for its examiners as well as provide additional time for covered credit unions to make any strategic and operational changes they need to prepare for risk-based capital implementation.

The parties also strongly urge the NCUA to consider the impact of the final current expected credit loss accounting standard promulgated by FASB on the risk-based capital rule. At a minimum, RBC implementation must be delayed so that credit unions can understand and coordinate compliance with the FASB rule. Moreover, the parties further urge increased dialogue and coordination between the NCUA and FASB with respect to credit union forecasting models to minimize differing examination guidance. The results of such collaboration should be available to the industry by means of advance Q&As or other guidance.

III. <u>Request to Raise Complex Credit Union Threshold</u>

The parties suggest that the asset threshold for compliance with a risk-based capital rule should be increased to at least $500 million. This threshold was raised by the industry and previously rejected by NCUA in 2012 as part of the emergency liquidity regulation. This level also appears as an appropriate threshold in audit requirements. To advance meaningful regulatory relief, the parties endorse the approach utilized by other federal regulators in adopting the Small Business Administration's asset threshold of $550 million for determining "small entity" status.

The NCUA does not have a financial stability mandate or supervisory or regulatory authority over any financial institution requiring enhanced prudential standards necessary for maintaining financial stability.

In addition, members strongly believe that asset size should not be the sole factor dictating a complex credit union. Consideration must be given to the composition of portfolios and products and services offered to better identify complex credit union profiles. In this determination, the parties also urge the NCUA to annually index any threshold for growth and adopt exemptions from such classification wherever possible, such as for credit unions with more traditional products and services. Together with overall balance sheet risk, the parties note that derivatives, credit union service organizations ("CUSOs") and member business lending are activities that may pose extraordinary risk, beyond routine loans and investments, for which additional capital protection may be needed.

IV. <u>Conclusion</u>

It is imperative that any final risk-based capital rule properly balance potential NCUSIF losses with the vision of a credit union's management and Board to develop and implement strategic plans and products and services that best serve its membership, and it is our position that the current proposal does not strike that balance. The parties' member credit unions are well capitalized, responsibly managed and possess a demonstrated track record of assessing risk. We ask that these factors serve as the guide to NCUA in proceeding to delay the proposed risk-based capital rule, and in raising the threshold for complex credit unions to $500 million.

Thank you for your consideration of these views. The parties appreciate the opportunity to provide input and we remain available to address any questions or concerns that you or your staff may have at your convenience.

Sincerely,

Paul Gentile

John Bratsakis

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