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1001 Connecticut Avenue, NW Suite 1001 ▪ 800.446.7453 / 202.223.3920 ▪www.coops4change.org

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Contacts: Jennifer Rosenbaum, Callahan & Associates, 202.223.3920 or
Margaret Blankers, MJB Public Relations Group, 866.714.7041

Financial Experts Question Need and Value of Risk-Based Capital Rule

Rule would force CUs to act like banks, overriding key elements of the cooperative model

WASHINGTON, D.C. (April 24, 2014) – Panelists in a Wednesday webinar sponsored by Callahan & Associates discussed concerns and invited feedback on the proposed NCUA rule that would judge capital adequacy on a risk-weighted basis. The rule calls for an approach similar to the Basel III method, even while bank regulators are backing away from this method in favor of the traditional and simpler leverage ratio.

Panelist Doug Alldredge, CFO of First Credit Union in Chandler, Ariz., said a major unintended consequence of the rule's weightings would be to place credit unions at a competitive disadvantage, requiring them to charge higher loan rates or pay lower dividends, or both to accommodate higher capital levels.

Alldredge told more than 300 webinar attendees that " in every asset class but one, the proposed rule requires *more* capital through higher risk weights than banks."

"The risk weights for investments are especially punitive and inconsistent," he said. "Treasury securities and those guaranteed by NCUA or FDIC carry zero percent risk weight, regardless of maturity. But other types with no credit risk, such as securities guaranteed by Fannie Mae or Freddie Mac, or fully insured time deposits in other financial institutions, are weighted based on maturity."

Jim Vilker, NCOO, VP of Professional Services for CU*Answers, told the audience the focus of credit unions' boards and management teams would change under a risk-based capital rule, with member needs taking a back seat to the credit union's capital condition.

"It creates an entirely new regulatory risk, a "tenth risk," in addition to NCUA's traditional nine, for credit unions to understand, manage and mitigate." said Vilker. "NCUA's proposed rule states, 'The examiner has discretion to override the objective outcomes in the rule and require higher levels of capital based on" subjective judgment and agency expertise.' "

Chip Filson, panel moderator and Chairman of Callahan & Associates, stated that the rule, as currently written, would force credit unions to act like banks.

(More)

"A risk-based capital approach makes sense on a micro level, where judgments are made using each credit union's unique membership, local economic trends and business strategy," he said. "This is how credit unions have managed well for more than 100 years. But what works for individual circumstance does not scale up to a one-size-fits-all formula for every credit union.

"Credit unions spend a lot of time analyzing losses. They know their experience with the risk of certain asset classes that have greater risk, such as signature or credit card loans vs. first mortgages," Filson continued. "Reserve judgments reflect each credit union's institutional capabilities, historical knowledge and local market circumstances. A rule forcing every credit union to adopt the same risk formula compromises the policy-setting and judgments of every board and management team."

Financial industry expert Thomas Brown explained why the risk-based approach doesn't work. "It's obvious that neither man nor model can adequately assess a given asset's risk under all circumstances before the fact," he wrote on *Bankstocks.com* (April 22, 2014). "It doesn't make sense to spend a lot of time trying."

Because the rule could be the most intrusive ever proposed by NCUA, each presenter urged every attendee and others in the credit union community to comment. To facilitate this, may visit a new website, www.CreditUnionVoices.com, has been created to review comments submitted to NCUA, access information about the rule and, with a single click email their comments to NCUA. The homepage clock "countdown" shows how much time remains until the May 28 deadline for comments.

For more information, to view the archive recording, or request assistance in determining how the proposed regulation could affect a specific credit union, contact Chip Filson, Jon Jeffreys or anyone on the Callahan team at 800.446.7453.

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