

May 27, 2014

Via Federal eRulemaking Portal

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

**Re: RIN 3133-AD77
Proposed Rule: Prompt Corrective Action – Risk-Based Capital,
Integrating 12 C.F.R. Parts 700, 701, 702, 703, 713, 723 and 747,
79 Fed. Reg. 11184 (February 27, 2014) (the “Proposal”)**

Dear Mr. Poliquin:

This letter is submitted on behalf of Central Florida Educators Federal Credit Union (“CFE”) in response to the National Credit Union Administration’s (the “NCUA”) request for comment on the Proposal. The Proposal would amend 12 C.F.R. Part 702 regarding prompt corrective action, including replacing the NCUA’s current risk-based net worth requirements with new risk-based capital requirements for federally insured credit unions. CFE fully supports the NCUA’s efforts toward establishing a risk-weighting system that effectively quantifies the potential risks associated with individual credit unions. However, implementation of the Proposal will significantly impair our ability to operate competitively, strategically grow and serve as a source of strength to the industry. Failing to address these concerns will create an unnecessary competitive imbalance for our credit union and the credit union industry as a whole.

This comment letter identifies specific concerns with the Proposal and provides recommendations to the NCUA for their consideration while drafting the final rule. In addition, this comment letter makes several general comments regarding the overall impact that the Proposal would have if it were approved and adopted in its current form.

I. Section 702.103 – The Proposal’s Definition of “Complex” Is Too Simplistic

The Proposal seeks to establish new, more stringent risk-based capital standards for credit unions that the NCUA classifies as complex. Under the Proposal, complex credit unions are

defined as all credit unions with quarter-end total assets that exceed \$50 million. However, the Federal Credit Union Act states that “complex” credit unions should be defined by the NCUA “based on the portfolios of assets and liabilities of credit unions.” Accordingly, the Proposal’s establishment of an arbitrary threshold of \$50 million in total assets does not meet Congress’ mandate.

A more sophisticated analysis should be used to determine whether a credit union qualifies as complex under the Proposal. Such sophisticated analysis should account for the mix of a credit union’s assets and liabilities, including loans and investments. In addition, the definition should include consideration of the mix of products and services offered by a credit union. Failing to implement a more sophisticated analysis, and retaining a simplistic definition based solely on total amount of assets, would result in an unnecessarily broad application of the risk-based requirements.

This broad application would serve to undermine the purpose of dedicating significant resources to create business models designed for sophisticated, healthy, large, growing credit unions that serve as a source of strength for the industry. As proposed, the failure to distinguish the complexity of our credit union from the majority of other credit unions will prevent institutions from building strategic business models. CFE recommends a tiered approach toward classifying varying levels of complexity depending on the individual credit union’s portfolios.

II. The Proposal Would Frustrate Credit Union Growth and Long-Term Planning

The elevated risk-based capital requirements in the Proposal would require adequately capitalized credit unions with moderate risk portfolios to hold more capital than currently required under the risk-based net worth model. The proposed requirements would frustrate currently adequately capitalized credit unions from growing and would dissuade credit unions from **engaging** in certain types of credit union activities that have been assigned elevated risk-weightings. The inability to grow will undermine complex credit unions’ ability to gain critical market **penetration**, invest capital in new services, technology and resources and prevent them from **achieving** economies of scale necessary for them to successfully compete. The industry is weakened by discouraging strong institutions from undertaking strategic initiatives to become stronger **and** by encouraging less sophisticated institutions to shrink their balance sheets to meet the rule requirements. The Proposal would negatively impact the business operations of thousands of credit unions that have historically operated in a safe and sound manner.

The Proposal cites the recent increase in credit union failures resulting in several hundred millions of dollars in losses to the National Credit Union Share Insurance Fund. The Proposal states that those failed credit unions were “holding inadequate levels of capital relative to the levels of risk associated with their assets and operations.” Further “[e]xaminers ... warn[ed] officials at these credit unions that they needed to hold higher levels of capital to offset the risks in their portfolios, but the credit union officials ignored the examiners’ recommendations, which were **unenforceable**.” However, since the beginning of 2012, of the eight failed credit unions

that the NCUA Office of Inspector General (the “OIG”) investigated and prepared Material Loss Reviews, the OIG determined that only one credit union failed as a result of undercapitalization resulting from inadequate capital held in relation to their portfolio. The OIG determined that the majority of the other seven credit unions failed as a result of board oversight, management integrity, fraud and overstatement of assets.

The issues contributing to recent credit union failures will not be resolved by the requirements the Proposal seeks to impose. On the contrary, the Proposal’s requirements will weaken the industry. Therefore, CFE recommends lessening the proposed risk-weight requirements so as not to thwart the business operations of successful credit unions.

III. The Proposal Would Negatively Impact the Credit Union Industry by Reducing Asset Selection Flexibility

As currently drafted, by assigning more burdensome risk-weights to the asset classes discussed above and more lenient risk-weights to traditional asset classes (*i.e.*, automotive loans and unsecured loans), the Proposal will reduce credit unions’ flexibility to offer products in certain asset classes. Credit unions proudly distinguish themselves from other financial institutions by maintaining an acute awareness of the economic climate of their field of membership and tailoring their business strategies accordingly. Hampering credit unions’ flexibility to make these business decisions will result in increased competition among traditional asset classes and increased pressure on margins – with the ultimate injury to the industry being reduced earnings and capital.

IV. Section 702.104 – The Proposal Should Assign Risk-Weight Objectively

The risk-weight assigned to various characteristics of a credit union have not been assigned objectively or consistently. Appendix A illustrates the risk-weight assignments about which CFE has concerns by comparing the various risk-weights assigned in the Proposal with the CFE’s recommended risk-weights. Appendix A also provides reasoning for why each particular risk-weight should be adjusted.

Moreover, CFE is concerned that the Proposal combines non-dependent risks (such as concentration risk, interest rate risk, credit risk and market risk) to calculate the risk-weights for each asset class, which results in asset class risk-weights that are unrepresentative of the practical risk of the asset class. Analyzing the various risks separately to create a composite risk matrix would better allow the NCUA to evaluate individually the impact of each risk and factor in the particular environmental factors unique to each risk. Using a composite risk matrix would then allow the NCUA to develop a more accurate capital requirement model.

CFE is concerned with assigning risk-weights in excess of 100 percent. A stated goal of the Proposal is to “ensure that credit unions retain levels of capital that are commensurate with their level of risk.” The Proposal departs from this stated goal by assigning risk-weights in

excess of 100 percent of the asset. For the level of a credit union's capital to correspond in size or degree to the risk of individual assets, the credit union must maintain a level of capital equal to the cost of loss or failure of their assets, adjusted based on the perceived risk of such asset class failing. For the riskiest asset class, it is rational to require the highest percentage of capital to remain commensurate with the risk; however, assigning a risk-weight any greater than the potential loss created by holding such asset is not supportable. Therefore, CFE proposes adjusting all risk-weights to 100 percent or less to meet the stated goal of the Proposal.

A. Section 702.104(c)(2)(i) – Cash

The Proposal generally requires a risk-weight of 0 percent for all cash on hand held by a credit union, and requires a 20 percent risk-weight for all cash on deposit. Cash on deposit is defined in the Proposal to include “balances on deposit in insured financial institutions and deposits in transit.” Although CFE acknowledges that the risk-weight assignment for cash is less impactful than other categories addressed in this letter, the proposed risk-weight assignments are illustrative of the Proposal's failure to account for numerous obvious asset traits. Cash on deposit is no more susceptible to risk than cash on hand. Arguably, cash held in deposits exposes less risk to a credit union than cash on hand, which is not securely deposited into an account, and only held in registers, vaults and teller hands. Accordingly, CFE believes the NCUA's assignment of different risk-weights for cash in hand and cash held on deposit is improper, and recommends assigning a risk-weight of 0 to both cash in hand and cash held on deposit. In the alternative, CFE recommends that cash on deposit with governmental entities, such as the Federal Reserve Board, should be assigned a risk-weight of 0. In addition, cash on deposit at a federally-insured depository institution should be assigned a risk-weight of 0 up to the deposit insurance limit. Cash on deposit in excess of the insurance limit would be assigned a risk-weight of 20 percent.

B. Section 702.104(c)(2)(i) – Investments

The Proposal assigns securities guaranteed by the U.S. Treasury Department a risk-weight of 0 percent, while securities guaranteed by other government agencies, including the Fair Housing Administration (“FHA”), U.S. Department of Veterans Affairs and Agriculture Department, are assigned a 20 percent to 200 percent risk-weight, depending on the weighted-average life of the investments. Accordingly, the Proposal inconsistently applies interest rate risk to different types of government securities. Further, the appropriate risk-weight is not being applied to investments with longer maturity periods. For example, there is no greater credit risk in a security guaranteed by FHA with a five-year maturity, than a security guaranteed by the Treasury Department with a 15-year maturity.

CFE recommends a consistent application of risk-weights to investments guaranteed by the federal government, regardless of the agency making the guarantee. All investments guaranteed by the government should be included in the same asset class and be assigned a risk-weight of 20 percent.

In addition, the Proposal does not consistently and sufficiently address the differences in credit risk between government-sponsored enterprises (“GSEs”) and departments of the federal government, the debt issuances of which are direct obligations of the United States and for which both principle and interest are guaranteed by the full faith and credit of the federal government. Securities or loans issued or guaranteed by the latter should bear the same credit risk weightings as those assigned to U.S. Treasury securities.

C. Section 702.104(c)(2)(iii), (iv) and (v) – First Mortgage Loans

The Proposal assigns a risk-weight of 50 percent to the first 25 percent of assets that are current, prudently underwritten first lien real estate-secured loans (“First Mortgage Loans”). Thereafter, to account for concentration risk, the Proposal assigns an increased risk-weight of 75 percent for loans between 25 and 35 percent of assets, and assigns a risk-weight of 100 percent for First Mortgage Loans over 35 percent of a credit union’s assets. This tiered approach is inconsistent with the revised capital framework for banks, where a risk-weight of 50 percent is assigned to First Mortgage Loans, regardless of concentration. CFE recommends that the NCUA reduce the risk-weighted assignments for First Mortgage Loans with concentration levels exceeding 25 percent to a 50 percent risk-weight.

Finally, First Mortgage Loans exceeding 35 percent of total assets are assigned an equal risk-weight as delinquent First Mortgage Loans. The NCUA should not assign a greater risk-weight to an asset class solely because the concentration of that asset class has exceeded an arbitrary threshold. For example, if a credit union decides to expand their concentration in mortgages, the mortgages that are contracted for as a result of the expansion do not carry any more risk than mortgages first contracted for by the credit union. The NCUA should allow credit unions to address these issues in their individual concentration risk policies, rather than their risk-based capital policies.

Finally, assigning these two classes of assets to the same risk-weight category ignores the credit risk associated with delinquent loans, while continuing to place great importance on concentration risk.

D. Section 702.104(c)(2)(v) – Loans Held For Sale

The Proposal assigns all loans held for sale a risk-weight of 100 percent under the catchall provision for other on-balance sheet assets not otherwise assigned a specific risk-weight. CFE generally agrees with the majority of the assets classes listed in section 702.104(c)(2)(v), except for loans held for sale. As addressed in section IV.C of this comment letter, First Mortgage Loans are assigned risk-weights between 50 and 100 percent, depending on the concentration of those loans. Given that most loans held for sale in credit union loan portfolios are First Mortgage Loans, it is unreasonable for the NCUA to assign a 100 percent risk-weight to all loans held for sale, regardless of their concentration. The NCUA should consistently apply

the tiered threshold approach based on concentration levels for each type of asset class, rather than grouping certain asset classes into a catchall category and assigning an average risk-weight.

CFE also recommends providing a safe-harbor for loans held for sale that credit unions have contracted for sale with a GSE, as the credit risk dramatically decreases as soon as such arrangement is executed. Accordingly, CFE recommends assigning a risk-weight of 10 percent to this specific subset of loans held for sale.

E. Section 702.104(c)(2)(v), (vii) and (viii) – Member Business Loans

The Proposal assigns risk-weights of 100 percent to 200 percent for member business loans (“MBLs”), depending on the amount of MBLs as a percentage of total assets. MBLs with concentrations of less than or equal to 15 percent of assets will be assigned a risk-weight of 100 percent, MBL concentrations of 15 to 25 percent will be assigned a risk-weight of 150 percent, and MBL concentrations in excess of 25 percent will be assigned a risk-weight of 200 percent. Although MBLs may be more complex transactions than consumer loans, increasing the risk-weight based on the concentration of the MBLs does not align with the source of the risk. The source of risk in MBLs is not from the concentration, but rather in the underwriting of the MBL, a finding that the NCUA has made in multiple Material Loss Reviews performed on failed credit unions. Moreover, many MBLs are U.S. Business Administration CDC/504 loans that present much less risk than the risk-weights assigned in the Proposal suggest. Absent the NCUA’s adoption of a composite risk matrix approach as suggested in section IV of this letter, CFE recommends maintaining a tiered approach toward the assignment of risk, but in a modified version: 50 percent for concentrations less than or equal to 15 percent of assets; 75 percent for concentrations of 15 to 25 percent; and 100 percent for concentrations greater than 25 percent.

Without adjusting the risk-weights in the Proposal, the NCUA’s assignment of such high risk-weights for MBLs will dissuade credit unions from continuing to make these types of loans, ultimately thwarting a historically profitable product for numerous healthy and safe credit unions.

F. Section 702.104(c)(2)(vii) and (viii) – Other Real Estate-Secured Loans

The Proposal assigns a risk-weight of 100 percent to other real estate-secured loans less than or equal to 10 percent of assets and a risk-weight of 125 percent to the total amount of all other real estate-secured loans greater than 10 percent of assets and less than or equal to 20 percent of assets. The Proposal also assigns a risk-weight of 150 percent other real estate-secured loans greater than 20 percent of assets. The level of these risk-weights are concerning when compared to the relative risk-weight assigned to other types of loans, such as unsecured credit card loans, which are assigned a risk-weight of 75 percent under the Proposal.

The NCUA should consistently apply their tiered threshold approach across all asset classes. Failing to do so may produce unintentional results. Specifically, the absence of a tiered threshold approach to other real estate-secured loans will likely result in: (i) guiding the business decisions of certain credit unions by making certain products more costly to offer members than others; and (ii) increasing loan portfolio credit risk by promoting riskier, unsecured credit products. Accordingly, CFE recommends either adjusting the risk-weights assigned to varying concentrations of other real estate-secure loans or applying tiered risk-weights to other types of consumer loans based on the concentration of those loans.

G. Section 702.104(c)(2)(ix) – Credit Union Service Organizations (“CUSOs”)

The Proposal currently assigns a risk-weight of 250 percent for the total investments in all CUSOs. Such a broad application of risk-weight to all CUSOs does not take into consideration the riskiness of the business services performed by them. For example, CUSOs that engage in activities such as consumer mortgage origination, loan servicing and support, and student loan origination are historically more risky than CUSOs that engage in title insurance or marketing services; however, under the Proposal, a credit union must assign a risk-weight of 250 percent of their investment in each of those CUSOs to their total risk-weighted assets for calculation of their risk-based capital ratio. A one-size-fits-all approach is not appropriate when assigning risk-weights to different CUSOs whose risk varies dramatically depending on the types of services rendered. Accordingly, CFE suggests revising the Proposal to account for the varying risks in the services performed by different classifications of CUSOs.

H. Section 702.104(c)(2)(ix) – Mortgage Servicing Assets

The Proposal assigns a risk-weight of 250 percent to mortgage servicing assets (“MSAs”), crediting the heavy risk-weight to the complexity and variability of the risks associated with such assets, including interest rate risk and market risk. However, MSAs are one of the only asset classes to which mark-to-market accounting is consistently applied. Moreover, MSAs possess a value that is countercyclical to the market value of the underlying real estate assets, thereby reducing the market risk of the asset. Accordingly, the NCUA should reduce the risk-weights assigned to MSAs and apply the tiered threshold approach based on concentration levels that is ubiquitous in the Proposal. Using that approach, the NCUA could assign a risk-weight of 75 percent for mortgage servicing assets less than or equal to a 15 percent concentration and a 100 percent risk-weight for concentrations greater than 15 percent.

V. Section 702.105(c) – The Proposal Exposes Credit Unions to Subjective Judgment and Expertise of Examiners

Proposed section 702.105(c) provides that the appropriate minimum capital levels for an individual credit union cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria, and that the decision is necessarily based, in part, on a subjective judgment grounded in agency expertise. CFE opposes the allowance of any subjectivity in

the assessment of a financial institution's risk. To bestow such power to individual examiners would lead to an inconsistent application of the capital requirements, thereby rendering the entire risk-based capital framework useless. The NCUA should eliminate all language in the Proposal that would allow examiners to exercise subjectivity in determining an institution's credit risk.

IV. The Proposal Imposes Substantially More Severe Capital Requirements Than Those Required of Banks

The Federal Credit Union Act mandates the NCUA to prescribe regulations for prompt corrective action and capital requirements comparable to section 1831o of the Federal Deposit Insurance Act (the "FDI Act"). Any deviation from the standards established for banks under the FDI Act and its implementing capital framework approved in September 2013 ("Basel III") should be commensurate with the characteristics of the type of institution. Based on the comparative risk presented by banks and credit unions, imposing capital requirements more burdensome than those imposed on banks would be excessive.

As written, the Proposal holds "complex" credit unions to a substantially higher capital standard than commercial banks under Basel III. Healthy banks are able to raise secondary capital in order to support their capital position and support strategic growth. CFE's members and its peers cannot. It is unnecessary to exacerbate this disadvantage. Appendix B details the requirements in the Proposal that are more onerous on credit unions than those for banks.

V. The Proposal Would Unintentionally Subject Credit Unions to a Competitive Disadvantage

Finally, the misapplication of stringent capital requirements to credit unions would put them at a competitive disadvantage with banks and other financial institutions. Credit unions have shared great success throughout their operations because of their familiarity with their membership and local economic trends. Although a risk-based approach may make sense on an individual level where credit unions would assess their own risk based on the familiarity with their membership, local economy and perception of unquantifiable risk, the NCUA's application of risk-weights that are more stringent than the capital requirements of banks is an improper fit for the industry, particularly with respect to more complex credit unions with historically successful, safe business operations. As drafted, the Proposal will certainly result in decreased flexibility in credit unions' ability to adapt and respond to changing risks and environments.

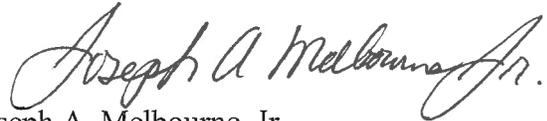
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Thank you for your review of this letter. CFE appreciates the opportunity to comment on the Proposal and respectfully requests that the NCUA consider the comments and recommendations set forth above and included in the appendices.

Mr. Gerard Poliquin
May 27, 2014
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Sincerely,

CENTRAL FLORIDA EDUCATORS
FEDERAL CREDIT UNION

A handwritten signature in cursive script that reads "Joseph A. Melbourne, Jr." The signature is written in black ink and is positioned above the printed name and title.

Joseph A. Melbourne, Jr.
President and CEO

Appendix B:
Comparison of Risk-Weight Assignments by Asset Class between Basel III and Proposal¹

Non-Investment Assets

Asset Type	Basel III (Banks < \$15B)	NCUA Proposal
Residential Mortgages Guaranteed by FHA or VA	0%	20%
Current First Mortgage Loans > 25% and ≤ 35% of Total Assets	50%	75%
Current First Mortgage Loans > 35% of Total Assets	50%	100%
Other Real Estate Loans > 10% and ≤ 20% of Total Assets	100%	125%
Other Real Estate Loans > 20% of Total Assets	100%	150%
Member Business Loans > 15% and ≤ 25% of Total Assets	100%	150%
Member Business Loans > 25% of Total Assets	100%	200%
Corporate Credit Union Non-perpetual Capital	N/A	100%
Corporate Credit Union Perpetual Capital	N/A	200%
Loans to CUSOs	N/A	100%
Investments in Credit Union Service Organizations	N/A	250%
Off-balance sheet items	Varies	75%

¹ This table is limited to asset classes for which the Proposal assigns risk-weights greater than or equal to the risk-weights assigned to similar asset classes under Basel III.

Investment Assets

	Asset Type	Basel III (Banks < \$15B)	NCUA Proposal
<i>Securities Guaranteed by U.S. Government Sponsored Agencies with:</i>			
	Weighted-Average Life ≤ 1 Year	20%	20%
	Weighted-Average Life > 1 Year ≤ 3 Years	20%	50%
	Weighted-Average Life > 3 Years ≤ 5 Years	20%	75%
	Weighted-Average Life > 5 Years ≤ 10 Years	20%	150%
	Weighted-Average Life > 10 Years	20%	250%
<i>Securities Guaranteed by General Obligations of State and Local Governments with:</i>			
	Weighted-Average Life > 3 Years ≤ 5 Years	50%	75%
	Weighted-Average Life > 5 Years ≤ 10 Years	50%	150%
	Weighted-Average Life > 10 Years	50%	200%
<i>Non-Agency Asset-Backed Securities with:</i>			
	Weighted-Average Life > 3 Years ≤ 5 Years	50% - 100%	75%
	Weighted-Average Life > 5 Years ≤ 10 Years	50% - 100%	150%
	Weighted-Average Life > 10 Years	50% - 100%	200%