Jordan, Sheron Y

From: Gordon Sam <gordon.sam@hawaiiantel.net>
Sent: Tuesday, April 08, 2014 4:24 PM
To: _Regulatory Comments
Subject: Comments on Risk-Based Capital Net Worth Proposal
Attachments: Comments on Proposed Risk One Credit Union.doc

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

My name is Gordon Sam. I am the Board Chair of Pearl Harbor FCU in Hawaii. Our Asset size is $340 million with 25,700 members.

Attached are additional comments on the Proposed Risk-Based Capital Net Worth

Thank you for taking the time to consider our concerns and comments.

Comments on Proposed Risk-Based Capital Net Worth

I examined the financials of all the credit unions in our State with assets of greater than $100 million and selected the credit union with the highest percentage of real estate loans (83.6% of their loans is in real estate) and the highest percentage (72.5%) of their real estate loans in first mortgages. I then used the NCUA Calculator for Proposed Risk-Based Capital Rule to see how their Risk-Based Capital Ratio would come out under the proposal. Under the current regulation their Risk-Based Net Worth is 7.04%, under the proposal their Risk-Based Capital Ratio would be 15.17%. Their current net worth is 11.46%. I further did an in-depth analysis of the calculations. Here is the data and some of the information in the proposed calculation.

Assets $507,064,947

In the Denominator of the proposed Risk-Based Capital Calculator,

Data from Calculator for Proposed Risk-Based Capital Rule

Investments	Amount	Weight calc
0 to 1 yr	$ 64,044,902	$ 12,808,980
>1 yr to 3 ry	$ 50,129,713	$ 25,064,857
>3 yr to 5 yr	$ 72,759,916	$ 54,569,937
> 5yr to 10 yr	$ 70,998,435	$ 106,497,653
> 10 yr	$ 97,848	$ 195,696
Total Investments	$ 258,030,814	$ 199,137,123

Loans	Amt	Weight Cal
Non-delilnq other loans	$ (11,303,954)	$ (8,477,965)
Reportable delin. Lns	$ 231,842	$ 347,763
1st < 25% assets	$ 126,766,237	$ 63,383,118
1st >25%	$ 40,379,571	$ 30,284,687
Other RE Ins& del. RE In	$ 25,902,452	$ 25,902,452
Member Busines Ln	$ 48,911,347	$ 48,911,347
Total Loans	$ 230,887,495	$ 160,351,402

Comments from looking at the above table:

1. Why does the calculator show a negative amount for Nondelinquent Other loans? If the number is positive instead of negative the proposed risk-based capital calculation would be 14.52% instead of 15.17%.

2. The sub-total for first mortgages is $167,145,808 with a weight calculation of $93,667,805. Investments in the category of >5yr to 10 yr is $70,988,435 and has a weight calculation of $160,497,653. In the event of a +500bp rise in interest rates the investments in a GSE may lose value but if held to maturity you get the principal back. On the other hand if you have a real estate loan that is paying you less than 5% you will loose. Yet your calculator conceders $71 million of investments >5yr to 10 yr far more risky than $167 million of first mortgages. Was it not RE mortgages that took down the Savings and Loans? It appears that the weights you have assigned to investment are way too high.
3. As I previously stated in a prior comment letter, NCUA should develop a risk-based capital net worth rule based on Basel III like the FDIC did for the Community Banks and remove the concentration risk and interest rate risk factors out of the proposal. By adding these additional variables into the proposed rule you are making compliance too complicated and unnecessarily restricting credit unions from making a profit. Problems with concentration risk and interest rate risk should be corrected in existing regulations.

Jordan, Sheron Y

From: Gordon Sam <gordon.sam@hawaiiantel.net>
Sent: Monday, March 03, 2014 9:17 AM
To: _Regulatory Comments
Subject: Prompt Corrective Action – Risk-Based Capital Comment Letter

Dear Secretary of the Board Poliquin,

I am writing on behalf of Pearl Harbor Federal Credit Union , which serves the Community of the Island of Oahu in the State of Hawaii . We have 25,702 Members and $337,666,374 in assets. Pearl Harbor Federal Credit Union appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposed rule, Prompt Corrective Action - Risk-Based Capital.

After using the NCUA Calculator for Proposed Risk-Basedsection Capital Rule and the CUNA Risk-Based Capital Simulator and in putting our budget for 2014, we conclude that we will be constrained in what we can do in future investments. This in turn will limit what we can provide to our members in better loan rates and dividends.

We agree that a risk-based capital is necessary to keep up with what other financial institutions are doing, but do not agree with the present proposal.

We do not agree that the individual examiners or supervisory examiners can impose and higher capital requirement on individual credit unions. We believe that this power is limited to the NCUA board only, similar to the restrictions imposed in Section 216 of the FCU Act §1790d.

We do not agree with some of the risk-weights assigned in the proposal. Why should an new auto loan and used auto loan which is secured have the same risk weight as an unsecured loan and credit card loan? Credit card loans have a delinquency more than 4 times as an auto loan. Why should a 7 year investment that is Federally backed have a risk-weight twice as great as a 30 year fixed mortgage?

The time line for implementation should be equivalent to that which the FDIC provided to Community Banks

Summary of our position:
The proposal will greatly limit our ability to provide better services to our members. It appears that NCUA is trying to include too much into a risk-base procedure i.e. including interest rate risk, and concentration risk all in one package. We question the some of the risk-weights assigned. These are our initial comments on the proposal. After further review we will probably send you additional comments.

Thank you for the opportunity to comment on this proposed rule and for considering our views on risk based capital requirements.

Sincerely,

Gordon Sam
94-449 UKEE ST
WAIPAHU, HI 96797

Jordan, Sheron Y

From: Gordon Sam <gordon.sam@hawaiiantel.net>
Sent: Tuesday, April 01, 2014 8:38 PM
To: _Regulatory Comments
Subject: Comments on Proposed Rule: PCA - Risk-Based Capital
Attachments: Comments to NCUA on the Proposed Risk March 2014.doc

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

My name is Gordon Sam. I am the Board Chair of Pearl Harbor FCU in Hawaii. Our Asset size is $340 million with 25,700 members.

Attached is our comments on the Proposed Risk-Based Capital Net Worth

Thank you for taking the time to consider our concerns and comments.

Gordon Sam

Comments to NCUA on the Proposed Risk-Based Net worth Rule

A. <u>SUMMARY</u> – My comments are based on a review of the subject proposal through reading, reviewing or using the following available information:

1. Reading summaries and daily articles published by trade associations such as CUNA and NAFCU.
2. Viewing Video presentations, Webinars put on by the trade associations
3. Reading sections of "New Capital Rule Community Bank Guide" published by the Board of Governors of the Federal Reserve System, the FDIC, and the Office of the Comptroller of the Currency
4. Reviewing a copy of the FDIC power Point Regulatory Capital Interim Final Rule
5. Using the NCUA Calculator for Proposed Riske-Based Capital Rule
6. Using CUNA's Risk-Based Capital Simulator
7. Using NAFCU's Risk Based Net Worth Capital Calculator
8. Reading sections of proposal published in the Federal Register

Conclusions:

- The proposed rule does not fit into the mold of Risk-Based Capital used by other Federal Regulators such as FDIC who has placed a Basel III rule on Community Banks
- It appears that NCUA is attempting to put too much into their proposal by including risk weight that try to control Interest Rate Risk and Concentration risk. This will add an additional layer of burden upon credit unions already overburdened and suffering from compliance fatigue, which is now hindering credit unions from providing better services to their members.
- NCUA already has implemented sufficient checks on credit unions in the areas of concentration risk in NCUA Letter 10-CU-03. Credit Union Boards are required by this letter to approve a Concentration Risk Policy to manage their concentration risk.
- NCUA already has implemented sufficient checks on credit unions in the area of Interest Rate Risk through NCUA Letter 12-CU-05
- By including concentration risk and interest rate risk controls in the proposed NCUA Risk-Based Capital proposal, some credit unions that would be considered Risk-Based Capital worthy under a Basel III system could be rated as lacking sufficient capital.
- NCUA should create a Risk-Based Capital Rule that is equivalent to other Federal regulators such as FDIC that is patterned after Basel III principals and eliminate the Concentration Risk and Interest Rate Risk elements of the proposal. If the current requirements of NCUA Letters 10-CU-03 and 12-CU-05 are not sufficient to protect the insurance fund fixed those letters and not create additional requirements in a new system.

B. <u>DISCUSSION</u>

1. Among all of the Federal financial regulators NCUA is the only Federal Regulator that does not have a Risk-Based Net Worth requirement that is based on a Basel system. The FDIC has just issued a Basel III risk-base net worth rule for Community Banks that will become effective on January 1, 2015. The rule gives community banks a four year transition period to have a minimum total capital ratio plus conservation buffer of 10.5% by 2019.
2. NCUA has seen the need to develop a risk-based capital net worth similar to other Federal regulators of financial institutions preferably something that resembled the Basel III system
3. NCUA issued a proposed Risk-Based Net Worth Capital Rule that appears to have taken parts of the Basel III rule for Community Banks and then modified risk weights that would take into account interest rate risk and concentration risk. For example risk weights for investments were modified to focus on interest rate risk as follows:
   - The FDIC uses a risk weight of 20% for GSE investments
   - NCUA is proposing risk weights for GSE investments that vary with maturity dates of the investments.
   - Maturity — risk weight
     - 0 to 1 yr — 20%
     - > 1yr to 3 yr — 50%
     - >3 yr to 5 yr — 75%
     - >5yr to 10 yr — 150%
     - >10yr — 200%

   (Note that this appears to be a carry over of the existing risk based net worth calculations that now appears on page 12 of the 5300, a method now considered inadequate for credit unions >$50 million in assets)

   The risk weights for real estate loans were modified to focus on concentration risk.
   - The FDIC uses a risk weight of 50% for real estate loans
   - NCUA is proposing risk weights for 1st mortgage real estate loans as follows:
     - Loans < 25% of assets — risk weight of 50%
     - Loans >25% to 35% of assets — risk weight of 75%
     - Loans >35% of assets — risk weight of 100%
   - NCUA is proposing risk weights for Other real estate loans as follows:
     - Loans <10% of assets — risk weight of 100%
     - Loans >10%-20% of assets — risk weight of 125%
     - Loans >20% of assets — risk weight of 150%

   It seems strange that in an interest rate risk environment a GSE investment in >5 yr to 10 yr maturity category is considered three times more risky than a 1st mortgage.

4. Using the NCUA Calculator for Proposed Risk-Based Capital Rule and the 5300 data of December 2013 for our credit union we have a Risk-Base Net Worth of 11.8%

5. Using the NAFCU's Risk Based Net Worth Capital Calculator and the FDIC risk weights would change our Net Worth for Dec. 2013 as follows:
   - FDIC risk weights for loans Net worth 12.87%
   - FDIC risk weights for investments Net worth 17.73%
   - FDIC risk weights for ln. & invest Net worth 20.11%

6. Using the CUNA's Risk-Based Capital Simulator and a budgeted projected growth of 1% in deposits, loans and investments a Net Worth would be 11.07%.

7. Since the proposed increase risk weights are part of the sum of the denominator of the calculations, the resulting Risk-Based Net Worth is artificially lowered from that of a true Basel III type net worth. Therefore a credit union that would be considered Well Capitalized under a Basel III calculation can be rated Adequately Capitalized or worse under the NCUA proposal because of a high concentration of real estate loans or long term GSE investments. With the modifications of risk weights to control interest rate risk and concentration risk, the proposed rule becomes extremely balance sheet sensitive and can drive a credit union's Risk-Based Net Worth Capital very easily by changes in loans or investments.

8. NCUA already has adequate checks in both Interest Rate Risk and Concentration risk to protect the insurance fund.
   - NCUA Letter 10-CU-03 covers Concentration Risk. Page 5 of the enclosure states "The board of directors must establish a policy which addresses its philosophy on concentration risk, limits commensurate with net worth levels, and the rationale as to how the limits fit into the overall strategic plan of the credit union." Footnotes in the enclosure reference Basel committee practices, yet Basel does not include concentration risk in their Risk-Based Net Worth rules.
   - NCUA Letter 12-CU-05 covers Interest Rate Risk. NCUA lists the five elements of an effective IRR management program as
     - A comprehensive written policy
     - IRR oversight by the board and management
     - Appropriate IRR measuring and monitoring system
     - Good internal controls
     - Informed decision-making based on IRR measurement system results.

9. NCUA should therefore not layer additional requirements in the proposed Risk-Based Net Worth in the area of Concentration Risk and IRR if adequate checks already exits else where. Credit unions are already overburdened and suffering from compliance fatigue that is limiting their ability to provide additional services to members. If the rules on Concentration Risk and Interest Rate Risk are inadequate then fix those

rules and don't put additional requirements in the proposed Risk-Based Net Worth Capital.

10. ***Questions*** - The FCIC has given Community Banks 4 year to transition into the 10.5% Net Worth, will NCUA give credit unions a 4 year transition period? Is the 10.5% minimum for a Well Capitalize Risk-Based Net Worth a logical calculated amount or was it just borrowed from the FDIC?

11. Side Issue – ***There has been a lot of discussion on NCUA's ability to raise the Risk-Based Net Worth Capital requirement for a credit union if they deem it appropriate.*** NCUA needs to specify if this can be done at the head examiners level, the Supervisor Examiners level, the Regional level or at the NCUA board level. Let us look at Section 216 of the FCU ACT - §1790d that covers Prompt Corrective Action, - Sub paragraph (c) covers net worth categories and (c) (1) (A) through (E) covers the five categories of net worth (A) well capitalized (B) adequately capitalized etc. Subparagraph (c) (2) is entitled Adjusting net worth levels. Sub paragraph (c) (2) (A) states in part – " --- the Board may, by regulation, and subject to subparagraph (B) of this paragraph correspondingly increase or decrease 1 or more of the net worth ratios specified in subparagraph (A) through (D) of paragraph (1) *(note this excludes (E) critically undercapitalized)* of this subsection in an amount in an amount that is equal to not more than the difference between the required minimum level most recently established by the Federal Banking agencies and 4 percent of total assets. Paragraph (h) is entitled – *more stringent based on other supervisory criteria- With respect to exercise of authority of the Board.* Subparagraph (h) (2) *the Board may not delegate its authority to reclassify an insured credit union into a lower net worth category or to treat an insured credit union as if it were in a lower net worth category.* Using this information, one can conclude that only the NCUA Board can require a credit union to have more capital than the proposed 10.5% needed to be Well Capitalized?