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MAY05'14 AM10:40 BOARD

April 29, 2014

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

Re: Prompt Corrective Action – Risked Based Capital Proposed Rule

Dear Mr. Poliquin:

I appreciate the opportunity to submit comments on the proposed Risk Based Capital rule. This is obviously a significant proposal that has the potential to change the ways in which Credit Unions operate and their decision making process.

Having worked in the banking industry for several decades, I appreciated the logic behind that industries risk based capital rule, simply due to the fact that some financial institutions have riskier assets on their books than others. Simple logic would conclude that they should have a higher level of capital to support those "riskier" assets.

When the NCUA's proposed ruling was announced, I was anticipating a ruling similar to the Banking industry and was anxious to read it. Was I ever surprised and disappointed! The pitfalls in the NCUA's version of Risk Based Capital gives cause for great concern to the Credit Union industry!

The first sentence on page 5 of the proposed rule reads "NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions." As this is "one" of the NCUA's primary missions, another mission of the NCUA's is to allow enough risk so that credit unions can make a respectable ROA, in order to support future growth. You know the saying, "No risk, no reward." In the case of credit unions, "No ROA, no asset growth, no longevity."

On page 12 you state that "In developing the new risk-based capital requirement for "complex" credit unions, NCUA set forth the following goals for the proposed rule." The 2nd goal listed reads as follows "the requirement should address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk."

- In attempting to address all of these various objectives, you are attempting to do the impossible. These risks do not work in tandem with each other. That's why we have separate policies that focus on each individual area of risk.

§702.103 Applicability of risk-based capital ratio measure: The proposed ruling states "For purposes of §702.102, a credit union is defined as "complex" and a risk-based capital ratio requirement is applicable only if the credit union's quarter-end total assets exceed fifty million dollars ($50,000,000), as reflected in its most recent Call Report.

In 2010, §702.103 of NCUA's regulations defined "complex as [i]ts quarter-end total assets exceed **ten million dollars ($10,000,000)**." The definition of "complex" should rely on factors that are actually related to risk. Please share the logic behind defining a credit union as "complex" simply based upon the total amount of assets it holds.

ALLL, limited to 1.25% of risk assets: The random selection of this percentage makes little sense. A credit union that has put money into the ALLL did so in anticipation of potential risks within its portfolio. In essence, they have allocated funds (removed them from earnings/capital) to help manage the risk. This limitation will penalize them for doing the prudent and correct thing. The ALLL's purpose is relatively the same as having adequate capital; it's there to assure the ongoing operations of the institution and to make sure that the NCUSIF is not negatively impacted.

Risk-weights for on-balance sheet assets:

- Non-delinquent student loans unconditionally guaranteed by a U.S. Government agency are risk rated at zero percent. Where would we classify delinquent student loans unconditionally guaranteed by a U.S. Government agency?
- A loan secured by a 2nd mortgage is weighted heavier than a non-delinquent unsecured credit card loan, other unsecured loans and lines of credit. This rationale doesn't consider important factors such as LTV, loan term, borrower's payment history, etc. Isn't a collateralize loan less risky than an uncollateralized loan?
- A loan secured by a 2nd mortgage is "equivalent to or weighted heavier than" a delinquent 1st mortgage loan or a non-federally insured student loan. Really?
- *Category 10 – 1,250 percent risk-weight:* Too vague and open for interpretation. Does this give the on-site examiner the ability to determine this?
- Treasury bills and U.S. government obligations have a 0% risk weighting, but a deposit in the Federal Reserve, has a 20% risk weighting.

- Proposal risk-weighs investments based on maturity. To risk-weight balance sheet assets for IRR, in isolation of the funding strategy, is inconsistent with how credit unions manage daily ALM decisions and is contrary to all modeling practices.
- A portfolio of 15-year, first mortgages with less than 25% of assets has a risk weight of 50%. The same asset class purchased in a GSE security with a weighted average life of five to 10 years is risk-weighted as an investment at 150% even though there is no default risk.
- A member business loan with a seven-year balloon maturity and with MBLs less than 15% of assets, is assigned a 100% risk weight. A seven-year bullet agency security with no credit risk is assigned a 150% weight.

§702.105 Individual minimum capital requirements: "NCUA may establish increased individual minimum capital requirements upon its determination that the credit union's capital is or may become inadequate in view of the credit union's circumstances." "The decision is necessarily based, in part, on subjective judgment grounded in agency expertise."

- None of the examples you gave justify this kind of "subjective judgment." The examples you stated need to be addressed in other ways, such as stopping those behaviors. The damage has already been done. Increasing their capital requirements will not solve what's already been done.
- This appears to be a way of covering anything this proposal has missed.
- The ability to override this rule enables examiners to unilaterally substitute their judgment for the responsibility of the board and management, who set and maintain appropriate policies for the credit union.

In general, I would like the Board to consider the following thoughts regarding the proposal as it currently reads:

- Under NCUA's proposed rule, our credit union has a Risk-Based Capital ratio of 16.30%. Under the Basel III limits, HVFCU has a Risk-Based Capital ratio of 21.08%. Huge difference. Obviously much more restrictive.
- Credit Union's faired remarkably well, compared to banks, throughout this country's worse economic period since the great depression. Leverage ratios worked far better than risk-based ratios. NCUA has not justified the need for the rule adequately.
- The risk based ratios that credit unions hold under this proposed ruling may be fine currently, but what happens when loan-to-share ratios rise back up to healthier levels. Our risk based ratios will slide downward. Will this cause us to turn down loans we should be making?
- National Credit Union Share Insurance Fund 1% deposit should not be ignored in the risk-based capital calculation. It is a liquid asset belonging to the credit union.

- Every business decision we make going forward will be impacted by us reviewing the impact on capital. Instead of focusing on the needs of the member, we will be focused on the needs of the Share Insurance Fund.
- The CUSO risk metric is not justified when the true nature of a CUSO investment is considered. The figure is strikingly arbitrary for several reasons, including the fact that there is no differentiation based on the business purpose of the CUSO, the ownership structure of the CUSO – single or multiple owners – or the corporate structure of the CUSO. The delinquent consumer debt over 60 days is risk rated at 150% and delinquent first lien mortgage debit is risk rated at 100%. However, investments in CUSOs are deemed riskier, with a 250% risk rating
- More time is needed for the rule to be phased in. It took the NCUA longer to write this proposal then is being provided for us to implement it.

Respectfully Submitted,

Timothy K. Ames
President & CEO