Florida Credit Union®

May 14, 2014

Gerald Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
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Mr. Poliquin,

Any risk-based capital regulation must have credibility industry-wide, from both the perspective of NCUA and credit unions. One key component of this credibility is that our regulation emulates the work done by other regulators in this country. The system that is being phased in today by banks, Basel III, emulates international banking standards that have been jointly developed by the central banks of the major industrialized countries.

Currently, NCUA's version of a risk-based capital regulation has little resemblance to the national and international Basel standard. The current NCUA risk-based net worth system imposes different capital requirements on different assets. Risk-Based Net Worth is only applicable for credit unions if the minimum RBNW calculation exceeds six percent to be classified as complex and the credit union exceeds fifty million dollars in assets. Under the current regulation, a credit union's risk-based net worth requirement is the aggregate of the standard component amounts shown below, each expressed as a percentage of the credit union's quarter-end total assets as reflected in the most recent call-report.

Standard Calculation of RBNW Requirement
With Risk Portfolios Defined

Risk portfolio	Assets, liabilities, or contingent liabilities	Amount of risk portfolio (as percent of quarter-end total assets) to be multiplied by risk weighting	Risk weighting
Long-term real estate loans	Total real estate loans and real estate lines of credit (excluding MBLs) with a maturity (or next rate adjustment period, if variable rate) greater than 5 years	0 to 25.00% Over 25.00%	.06 .14
MBLs outstanding	Member business loans outstanding	0 to 12.25% Over 12.25%	.06 .14
Investments	As defined by federal regulation or applicable State law	*By weighted average life*: 0 to 1 year >1year to 3 years >3 years to 10 years >10 years	 .03 .06 .12 .20
Low-risk assets	Cash on hand and NCUSIF deposit	All %	.00
Average-risk assets	100% of total assets minus sum of risk portfolios above	All %	.06
Loans sold with recourse	Outstanding balance of loans sold or swapped with recourse, except for loans sold to the secondary mortgage market with a recourse period of 1 year or less	All %	.06
Unused MBL commitments	Unused commitments for MBLs	All %	.06
Allowance	Allowance for Loan and Lease Losses limited to equivalent of 1.50% of total loans	Limited to equivalent of 1.50% of total loans (expressed as a percent of total assets)	(1.00)

A credit union's RBNW requirement is the sum of eight standard components. A standard component is calculated for each of the eight risk portfolios, equal to the sum of each amount of a risk portfolio times its risk weighting. A credit union is classified "undercapitalized" if its net worth ratio is less than its applicable RBNW requirement.

In addition, a credit union may substitute one or more alternative components in place of the corresponding standard components, when any alternative component is smaller.

Alternative Components for Standard Calculation

Long-term Real Estate Loans

Amount of long-term real estate loans by remaining maturity	Alternative risk weighting
> 5 years to 12 years	.08
> 12 years to 20 years	.12
> 20 years	.14
The "alternative component" is the sum of each amount of the long-term real estate loans risk portfolio by remaining maturity (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

Member Business Loans

Amount of member business loans by remaining maturity	Alternative risk weighting
Fixed-rate MBLs 0 to 3 years	.06
> 3 years to 5 years	.09
> 5 years to 7 years	.12
> 7 years to 12 years	.14
> 12 years	.16
Variable-rate MBLs 0 to 3 years	.06
> 3 years to 5 years	.08
> 5 years to 7 years	.10
> 7 years to 12 years	.12
> 12 years	.14
The "alternative component" is the sum of each amount of the member business loans risk portfolio by fixed and variable rate and by remaining maturity (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

Investments

Amount of investments by weighted-average life	Alternative risk weighting
0 to 1 year	.03
>1 year to 3 years	.06
>3 years to 5 years	.08
>5 years to 7 years	.12
>7 years to 10 years	.16
> 10 years	.20
The "alternative component" is the sum of each amount of the Investments risk portfolio by weighted-average life (as a percent of quarter-end total assets) times its alternative factor. Substitute for corresponding standard component if smaller.	

In the current regulation, Interest Rate Risk could be mitigated by the use of alternative components in the risk-based calculation. However, in the proposed regulations, the only determining factors would be based on the overall portfolio, then weighted on its percentage of assets.

Below is an illustration of the three risk weighting systems we are comparing, including the current regulation, proposed, and Basel III:

Current, Proposed and Small Bank Basel III System Selected Comparisons

	Current CU System	Proposed CU System			Small Bank Basel III		
Denominator	Current Marginal Required Capital	Weights	Marginal Required Capital: Adequate	Marginal Required Capital: Well	Weights	Marginal Required Capital: Adequate	Marginal Required Capital: Well
Cash on hand	0.00%	0%	0.00%	0.00%	0%	0.00%	0.00%
INVESTMENTS							
Investements: WAL < 1 year	3.00%	20%	1.60%	2.10%	20%	1.60%	2.10%
Investments: WAL 1-3 years	6.00%	50%	4.00%	5.25%	20%	1.60%	2.10%
Investments: WAL 3-5 years	12.00%	75%	6.00%	7.88%	20%	1.60%	2.10%
Investments: WAL 5-10 years	12.00%	150%	12.00%	15.75%	20%	1.60%	2.10%
Investments: WAL > 10 years	20.00%	200%	16.00%	21.00%	20%	1.60%	2.10%
Corporate CU member capital	6.00%	100%	8.00%	10.50%	100%	8.00%	10.50%
PIC/Perpetual Contributed Capital	20.00%	200%	16.00%	21.00%	100%	8.00%	10.50%
LOANS							
Nondelinquent nonfederally GSL	6.00%	100%	8.00%	10.50%	100%	8.00%	10.50%
Nondelinquent other loans	6.00%	75%	6.00%	7.875%	100%	8.00%	10.500%
Reportable delinquent other loans**	6.00%	150%	12.00%	15.75%	100%	8.00%	10.50%
Delinquent 1st mortgage real estate*	N.A.	N.A.	N.A.	N.A.	100%	8.00%	10.50%
Residential mortgages Gty'd by FHA or VA	8.00%	20%	1.60%	2.10%	0%	0.00%	0.00%
Nondelinquent 1st mortgage real estate loans*							
< 25 % of assets	6.00%	50%	4.00%	5.25%	50%	4.00%	5.25%
Excess of 25 - 35% of assets	14.00%	75%	6.00%	7.88%	50%	4.00%	5.25%
Excess of 35% of assets	14.00%	100%	8.00%	10.50%	50%	4.00%	5.25%
Other real estate and delinquent real estate							
< 10% of assets	6.00%	100%	8.00%	10.50%	50%	4.00%	5.25%
Excess of 10% - 20% of assets	6.00%	125%	10.00%	13.125%	50%	4.00%	5.25%
Excess of 20% - 25% of assets	6.00%	150%	12.00%	15.75%	50%	4.00%	5.25%
Excess of 25% of assets	14.00%	150%	12.00%	15.75%	50%	4.00%	5.25%
Small business administration loans	6.00%	20%	1.60%	2.10%	20%	1.60%	2.10%
Member business loans/commercial loans							
< 15% of assets	6.00%	100%	8.00%	10.50%	100%	8.00%	10.50%
Excess 15 - 25% of assets	8.00%	150%	12.00%	15.75%	100%	8.00%	10.50%
Excess of 25% of assets	14.00%	200%	16.00%	21.00%	100%	8.00%	10.50%
* Excludes MBLs secured by real estate.							
OTHER ASSETS							
NCUSIF deposit	6.00%	-100%	-8.00%	-10.50%	N.A.	N.A.	N.A.
Goodwill		-100%	-8.00%	-10.50%			
Identifiable intangible assets		-100%	-8.00%	-10.50%			
Loans to CUSOs	6.00%	250%	20.00%	26.25%	N.A.	N.A.	N.A.
Mortgage servicing assets	6.00%	250%	20.00%	26.25%	Varies	Varies	Varies
All other assets		100%	8.00%	10.50%			100.00%
OFF BALANCE SHEET ITEMS							
Loans sold with recourse	6.00%	75%	6.00%	7.88%	Varies	Varies	Varies
Unfnd commit on business loans (75% conversion)	6.00%	100%	8.00%	10.50%	Varies	Varies	Varies
Unfnd commit on non-business loans (10% conversion)	6.00%	75%	6.00%	7.88%	Varies	Varies	Varies
ABS "comprehensive understanding" penalty	6.00%	1250%	100.00%	131.25%	1250%	100%	131%
**Proposed included delinquent mortgages							
*excludes member business loans secured by real estate							

The scoring structure in the current risk-based net worth system, proposed system, and the Basel III standard are totally different. NCUA has taken risk weighting tiers out of the current scoring system and dropped them in to their Basel look-a-like proposed capital regulation. The problem with this is that the risk weighting tiers are radically different than those used in the Basel system as well as the international Basel system. In effect, NCUA has taken the scoring system for football and tried to impose it on soccer. The two systems have very little similarity to each other. It is not appropriate for NCUA to adopt the framework of the Basel system, yet take the most critical parts from a regulation that has absolutely nothing to do with Basel.

NCUA regularly issues guidance with all other federal financial institution regulators through the FFIEC. One must ask why NCUA feels compelled to take a radically different approach than the rest of the federal financial institution regulators as well as the international banking community. Issuing this regulation should be a very simple process in that it should emulate the Basel III accords that all other financial institutions are going to be subject to throughout the phase out period which ends in 2019. Adopting the actual Basel III format accurately gives both NCUA and the credit union industry credibility to all outside parties.

What should a capital regulation do and what should it not do?

Capital is a cushion against losses to ensure that the financial institution survives, and most importantly, that the deposit insurer has no claim to pay, should that financial institution fail. Throughout the proposal document, there are discussions of a variety of risk types that NCUA seems to be attempting to manage with this regulation. Capital is supposed to be a buffer against losses against all types of risk, in all types of environments.

Concentration risk is not a risk in and of itself; it must have some other risk present. Credit risk is the most common form of loss in a financial institution. When you look at data across all financial institution types, credit risk is the number one cause for a financial institution failing. The next largest risk creating financial impact is interest rate risk. Concentration risk magnifies other risk. For example, if a financial institution has done a very poor job of underwriting a particular asset class of loan, creating credit risk, then that financial institution has a large concentration of credit risk, creating a larger threat to the organization. The same situation applies to interest rate risk and liquidity risk.

All of these risks are very complex and require very technical and ongoing management from the standpoint of the financial institution. In the case of credit risk, underwriting guidelines need to be clearly established. There must be controls to ensure the guidelines are followed, with proactive monitoring in place to be sure they are effective. In the case of interest rate risk, a clear interest rate risk management policy, or ALCO policy, must be established to define how much interest rate risk a financial institution is willing to accept. This risk is measured on an ongoing basis through very complex modeling. These two risks can change dramatically as the economic environment changes both on the national and local basis.

During the recession, we experienced negative economic growth, very high unemployment, and a decrease in real estate values across the country for the first time in 50 years. Our current PCA capital system, where credit unions must have a retained earnings to asset ratio of at least 7% to be well capitalized, served the industry well throughout the recession. Part of this is because the average credit union had capital way beyond 7%, almost 50% more than the minimum well capitalized level as defined in the current capital regulation.

The capital regulation is not an effective tool to manage interest rate risk, credit risk, or concentration risk because these risks require dynamic and technical management on an ongoing basis.

To respond to the environment, risk must be managed dynamically, both from the regulator perspective as well as on the credit union side. This was done very effectively throughout the long recession. Building all of this into a capital regulation assumes NCUA can predict the environment, which is an invalid assumption. Overall, our industry fared pretty well through the recession given the severity of it, especially if you take corporate credit unions out of the equation. Assessments to credit unions relative to natural person credit union losses were minimal. The table below shows the actual share insurance fund premiums for natural person credit unions were 0 from 2011-2013. Losses have been minimal through the recession in comparison to the corporate stabilization losses experienced by credit unions.

Year	Estimated Stabilization Fund Assessment	Actual Stabilization Fund Assessment	Estimated Share Insurance Fund Premium	Actual Share Insurance Fund Premium
2009	N/A	4.73 bps	N/A	10.27 bps
2010	5-15 bps	13.4 bps	10-25 bps	12.42 bps
2011	20-25 bps	25.0 bps	0-10 bps	0 bps
2012	8-11 bps	9.5 bps	0-6 bps	0 bps
2013	8-11 bps	8.0 bps	0-5 bps	0 bps
2014	None	TBD	0-5 bps	TBD

This is very strong evidence that the current capital structure and risk management practices on both the regulator side and the credit union side are not broken. In fact, the state of credit unions after the recession is evidence that the existing regulations are highly effective. One gets the sense that NCUA staff is considering losses from the last recession in various asset classes and building a capital regulation to respond to that single period, rather than taking a long term view. A more appropriate approach would be looking back 50 years to analyze what has happened, as well as looking ahead, relative to the environment(s) we expect to face.

The point of all this is that the capital regulation is not a substitute for competent management on the institution side or competent supervision on the regulator side. To build those into a capital regulation, along with extremely conservative risk ratings, is going way beyond what a capital regulation is designed to do.

NCUA must take a long-term view looking backward and forward, as well as analyzing credit unions from a big picture perspective when developing a capital regulation.

There are references to recent losses on various asset classes in the section of the proposed regulation where risk weights are discussed. For example, in the member business lending section, there is a narrative that describes how these are high risk loans, citing an Inspector General report from 2010 that contained an analysis of historical losses from ten credit unions. Seven of the credit unions cited in this report had reportable issues with Member Business Lending. Below is the summary analysis from this OIG Report:

	Management Actions Contributing to Failure						Supervisory Shortcomings	
	Ineffective Management (*Poor Planning and Weak Oversight*)	Concentration Risk	New Program or Services & Third Party Due Diligence	Liquidity Risk	Credit Risk	Member Business Lending	QCR Deficiency	Poor Examination Procedures
Huron River	x	x	x	x	x	x		x
Norlarco	x	x	x	x	x	x		
New London	x	x					x	x
High Desert	x	x			x	x	x	x
Center Valley	x	x						x

	Management Actions Contributing to Failure						Supervisory Shortcomings	
	Ineffective Management (*Poor Planning and Weak Oversight*)	Concentration Risk	New Program or Services & Third Party Due Diligence	Liquidity Risk	Credit Risk	Member Business Lending	QCR Deficiency	Poor Examination Procedures
Cal State 9	X	X	X	X	X			X
Eastern Financial Florida	X	X	X	X	X	X		X
Clearstar	X	X	X	X	X	X		X
Ensign	X	X	X	X	X	X		X
St. Paul	X	X		X	X	X	X	X

Commentary in the second mortgage area also describes high losses. These losses are clearly related to the recession because, as you look back over the last 30 or 40 years, their loss ratios have otherwise mirrored mortgage products. In the commentary of the first mortgage side, there is a lot of discussion about concentration risk and losses during the recession. Again, when you look back over 40 – 50 years, real estate loans have been very safe. In fact, the recession was the first time in 50 years, on a nationwide basis, that we saw a decline in real estate values. Real estate values bottomed out approximately two to three years ago, and are increasing nationwide. All analysts expect the housing market to continue to recover. The capital regulation is written as if we are always going to work within the climate we experienced in the ’07 through ’11 recession. With the risk weightings being proposed, I believe the weights would place us in such a box that it would be difficult to be competitive with other financial service providers in the actual, current, and future marketplace.

Credit unions are in the risk management game, not the risk avoidance game. We must take on risk, get paid for it, and manage it effectively to be economically viable. Loss ratios from the recession assume that credit unions cannot respond to and mitigate risk. In reality, the overall performance of credit unions throughout the recession should be justification for lower capital ratios because credit unions were able to mitigate the risk in many ways and use a small part of their capital base to offset losses. Once more, with the corporate credit union issue aside, credit unions were able to respond by adjusting operations, funding immediate losses out of current earnings, and using capital to absorb remaining losses. For this reason, risk weights must be assigned looking at the entire credit union, its earnings potential, and its ability to mitigate losses. Credit unions are far more than just a group of individual earning asset classes. Rather, credit unions are economic entities that have proven their ability to generate significant earnings from many different sources. This was especially true during the recession where fees were adjusted, expenses were reduced, and loss mitigation efforts were increased dramatically to allow the industry as a whole to survive the recession in a very strong manner. Again, NCUA must take a very long term view, backward and forward, and look at credit unions in their entirety when building a capital regulation that makes sense for the industry.

What is the implied balance sheet of a credit union based on the risk weightings, and is it economically viable looking forward?

The credit union charter has many disadvantages over competitors in the marketplace including banks. The first disadvantage is that our only source of capital is retained earnings. That means our entire capital base must be based out of retained earnings unless alternative capital sources are developed. Banks, in contrast, are able to issue stock in addition to retained earnings. They are able to grow their capital bases very rapidly. Stock is counted at the same level as retained earnings on the bank side, even though stock holders expect a return.

One of the biggest disadvantages of the charter is a limited field of membership. Although this is evolving, it is still a huge hindrance to credit unions nationally. This is especially true when you consider that all our services are evolving to be delivered electronically which effectively eliminates geographic constraints.

The power and authority credit unions have, generally speaking, are much less than banks. Most significant is the 12.25% cap on commercial lending, with the exception of those credit unions, such as Florida Credit Union, who have received the low income designation. In this case, those credit unions have no cap, although the proposed regulation essentially reestablishes one at the 15% level given the risk weighting of commercial loans. Below is a comparison that CUNA created detailing the differences between credit unions and banks

POWER/LIMITATIONS	CREDIT UNIONS	BANKS [2]
Member Business Loans	A federally insured credit union's member business lending is restricted. • Such lending may not exceed the lesser of 1.75% of its net worth or 12.25% of total assets, with some exceptions.[3] 12 U.S.C. § 1757a; 12 C.F.R. §723.16(a).	National banks face no specific restrictions on commercial loans. 12 U.S.C. §24; 12 C.F.R. part 32.
General Lending Limits	A credit union's lending to one member is limited to 10% of the credit union's unimpaired capital and surplus. 12 C.F.R. §701.21(c)(5). • There is a 15-year maturity limit for loans except for lines of credit, that a mortgage on a principal residence may be up to 40 years and a second mortgage on the principal residence may be up to 20 years. Certain mobile home and home improvement loans may also be up to 20 years. 12 C.F.R. §701.21(c)(4); (f); (g). • Federal credit union loans may not have prepayment penalties. 12 C.F.R. §701.21(g).	A national bank's total outstanding loans to one borrower may not generally exceed 15% of the bank's capital. • An additional 10% is permissible if secured by readily marketable collateral. 12 U.S.C. § 84(a); 12 C.F.R. part 32. • National banks generally do not face maturity limits. • Banks frequently impose prepayment penalties.

Authorized Investments[4]	Federal credit unions have limited investment authority: • Obligations issued by or fully guaranteed by the U.S. Government; • Obligations of a State or political subdivision, up to 10% of unimpaired capital and surplus; • Obligations issued by banks for cooperatives, FHLBs, or guaranteed by GNMA, FNMA or FHLMC; • Loans to other credit unions; • Accounts of federally insured institutions; • Shares of a credit union service organization (CUSO)[5] up to 1% of total paid-in and unimpaired capital and surplus; • Shares of the National Credit Union Central Liquidity Facility; • Certain other investments as regulated by NCUA such as certain mortgage note repurchase transactions. 12 U.S.C. § 1757; 12 C.F.R. Part 703-14.	Banks have broad investment authority. • Securities issued or guaranteed by the U.S. Government, State, territory or Political Subdivision (including municipal obligations); • Obligations issued by wholly owned U.S. Government corporations (e.g., FHLBs) or in obligations guaranteed by GNMA, FNMA or FHLMC Mac and state housing corporations; • Banker's acceptances issued by another non-affiliated bank or thrift; • Deposit accounts of any insured institution; • Banker's banks or holding companies (up to 10% of capital and surplus); • Bank service companies (up to 10% of capital and surplus as long as all investments in bank service companies do not exceed 5% of assets); • The bank's own stock (for a legitimate business purpose); • Asset-backed investment grade securities or auction-grade securities; • Commercial real estate mortgage-backed securities; • Investment grade commercial paper; • Community development and public welfare projects; • Convertible securities; • Corporate debt bonds and securities; • Foreign government securities; • Insurance company products and investment funds; • Life insurance for business needs; • Money market preferred stock; • Mutual fund shares; MORE

<table>
<tr><td></td><td></td><td>Non-controlling minority investments in business entities;
Investment-grade small business securities or Investment-grade marketable trust-preferred securities. 12 U.S.C. § 24; 12 C.F.R. Part 1.</td></tr>
<tr><td>Broker/Dealer Activities</td><td>Federal credit unions are not authorized to engage in broker-dealer activities, i.e., selling non-deposit investments directly to their members.
Credit unions cannot register as broker-dealers. NCUA Letter to Federal Credit Unions 10-FCU-03 (Dec. 2010).
A federal credit union may act as a "finder," to refer through a networking agreement or other means, a registered third party broker to its members for the sale of non-deposit investment products. 12 U.S.C. § 1757; 12 C.F.R. § 721.3(f). 12 C.F.R. § 721.6; OGC Op. 02-0523a (May 24, 2002). NCUA Letter to Federal Credit Unions 10-FCU-03 (Dec. 2010).</td><td>Banks may engage in broker-dealer activities.
SEC regulations require banks that engage in securities activities to register as a broker-dealer.
However, there are specific exceptions to the registration requirements.
Banks that limit their activities to the exceptions are exempt from broker-dealer registration.
Banks may also act as finders to refer brokers to their customers. 15 U.S.C. § 78c(a)(4)(F); 12 C.F.R. part 218.</td></tr>
<tr><td>Related Organizations</td><td>Credit unions do not have holding companies.
However, in addition to being able to invest in a credit union service organization (CUSO, as indicated above), credit unions may also lend to a CUSO, up to 1% of their paid-in and unimpaired capital and surplus. 12 U.S.C. § 1757(7)(I); 12 C.F.R. § 712.2.
A CUSO is permissible for a credit union loan or investment only if it primarily serves credit unions, its membership or the members of credit unions contracting with the CUSO.</td><td>A well-capitalized and well-managed national bank may control or invest in a financial subsidiary, such as a holding company, subject to certain other limitations and safeguards.
A financial subsidiary may engage: (1) in any activity closely related to banking (as determined under section 4(c)(8) of the Bank Holding Company Act); (2) in any activity in the United States that a bank holding company may engage in outside the United States; (3) in the underwriting, distributing, and dealing in of all three types of securities; (4) in acting as an insurance broker or agent; and (5) in any activity the Treasury and Federal Reserve determine to be financial in nature or incidental to a financial activity.
Financial subsidiaries may also engage in activities permissible for operating subsidiaries. 12 U.S.C. § 24a; 12 C.F.R. § 5.39(e).</td></tr>
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Net Worth (Capital) Requirements[6]	Federally insured credit unions are required to maintain at least 6% net worth to be considered adequately capitalized; 7% net worth is required to be well-capitalized. 12 U.S.C. §1790(d); 12 C.F.R. part 702. • Credit unions may only build net worth through retained earnings. • Credit unions cannot issue stock or other capital instruments • Credit unions may not rely on supplementary capital to meet net worth requirements.	National banks must have capital equal to at least 4% of total assets. Because of their complexities, they are also subject to a total risk-based capital ratio of 8 % capital to risk-weighted assets and a Tier 1 risk-based capital ratio, requiring 4% Tier I capital to risk-weighted assets. 12 U.S.C. § 1831o; 12 C.F.R. part 325. • Banks may raise capital through the issuance of stock. 12 U.S.C. § 51a; • Banks may rely on supplementary capital to meet risk-based requirements.

Usury	Federal credit unions may not charge more than 18% APR for most loans and 28% for loans made under NCUA's Short-Term, Small Amount Loan program.[7] 12 U.S.C. § 1757(5)(A)(vi); 12 C.F.R. § 701.21(c)(7)(ii)(B); NCUA Letter to Federal Credit Unions 11-FCU-04 (April 2011).
	
	• Loans made by federal credit unions under the Short-Term, Small Amount Loan program must comply with the following conditions:
	  ○ Principal amount between $200 - $1,000;
	  ○ Term between 1 - 6 months;
	  ○ Maximum application fee of $20;
	  ○ Recipient must have been a member for at least 1 month;
	  ○ Fully amortized; and
	  ○ Rollovers are prohibited.
		The interest a national bank may charge is generally limited to the maximum permitted by the laws of the state in which the bank is located. 12 U.S.C. § 85.

[6] Credit unions and banks are subject to additional risk-based requirements, depending on their activities.
[7] State chartered credit unions' are not allowed to make Short-Term, Small Amount loans under this NCUA program and are not covered by the federal usury ceiling but their interest rates are subject to the maximum allowed by state law.

The point of this is that the credit union charter poses a number of significant disadvantages. The proposed capital regulation compounds those disadvantages by requiring much more capital than the typical bank would be required to have for a given asset class. This translates to a severe limitation in terms of what a credit union will be able to do over the next five to ten years. The implied balance sheet structure, based on the proposed capital regulation, is as follows:

- Commercial lending would be limited to roughly 15%, because of the heavier risk weighting
- Real estate lending would be limited to approximately 35% of assets regardless of the repricing structure of those loans
- Home equity loans/2nd lien mortgage loans would be limited to 10% of assets

The remainder of a credit union's balance sheet will be limited to very short-term investments, again, because of the risk weightings and consumer loans. NCUA and the rest of the industry need to assess whether this is truly viable.

Using member business loans as an example, the commentary by NCUA indicates that there are only 103 credit unions with commercial loans in excess of 15%. While it is true that credit unions do not have a large presence in commercial lending today, the commentary implies that the extremely conservative risk weightings on commercial loans should not be a problem to the entire industry. I have been on the board of a commercial lending CUSO since 2005. We see MBL volume increasing as credit unions struggle to put good earning assets on their books. The average loan to deposit ratio nationally is 70.83%. This is not very strong, and credit unions recognize that they must do a better job of putting earning assets on their books. This means that they must diversify their source of loans.

The same point can be made for real estate loans, especially real estate loans that have effectively mitigated their interest rate risk with repricing intervals on products such as ARMs, or where a credit union has hedged the interest rate risk in their portfolio in some way.

The chart that follows shows CUs by asset size with key performance measurements. Credit unions below $50 million are barely profitable and losing membership. Those CUs $50 million to $100 million are not faring much better. As we increase in size, we attain much better results but clearly not strong results. Again, the weights in the capital regulation will compound this problem for the reasons mentioned above.

December 2013 Call Report Data:

	# of CU's	% of Industry	Net Worth	ROA	Loans/Shares	Share Growth	Loan Growth	Member Growth
0-50M	4416	66.04%	12.59%	0.16%	56.32%	1.28%	2.19%	-1.19%
50M-100M	785	11.74%	11.21%	0.43%	61.12%	2.40%	4.08%	0.41%
100M-250M	703	10.51%	10.62%	0.51%	66.99%	3.22%	5.93%	1.49%
250M-500M	348	5.20%	10.91%	0.67%	69.40%	3.74%	7.92%	2.56%
500M-1B	226	3.38%	10.76%	0.76%	72.71%	4.21%	9.38%	4.16%
>1B	209	3.13%	10.54%	0.97%	74.06%	5.16%	9.92%	5.45%
Florida Credit Union			**10.73%**	**1.25%**	**96.01%**	**15.04%**	**13.61%**	**9.73%**

Risk Rating Categories:

We are comparing Basel III to the NCUA proposal for risk-based capital throughout this document.

1-4 Residential Mortgages:

Under the proposed NCUA Regulation, the following table is proposed:

First Lien Mortgages

Threshold	Proposed risk-weight (percent)
0–25% of assets	50
>25–35% of assets	75
Excess over 35% of assets	100

Jr. Lien (Second Mortgages)

Threshold	Proposed risk-weight (percent)
0–10% of assets	100
>10–20% of assets	125
Excess over 20% of assets	150

Under Basel III, first mortgage loans (1-4 residential) are given risk weights based on current status (delinquent vs non-delinquent) and whether the loan was prudently underwritten at 50% or 100%. Why does this proposal vary based on a percentage of assets and first or second lien versus delinquency status on the banking side? It seems NCUA is attempting to control the longer term interest rate risk market or concentration risk by increasing risk ratings by percentages of mortgage loans on the balance sheet. These controls should already be in place through the institution's ALM policies, credit risk programs, and management. This proposal would limit the ability for Americans to access credit, causing a decrease in economic growth and limiting the housing market recovery.

Florida Credit Union recommends that the Basel III risk weights of 50% be adopted for all first mortgage loans.

It is interesting to note that charge-offs for second lien products were only .05% in 2004. They were high during the recession, peaking at 1.33% by December 2010, but they are on their way to normalizing and were at .55% in December 2013. Clearly second lien mortgages do not deserve a higher risk weighting than credit cards. Their performance over the last 30 – 40 years, recession aside, justifies this asset class being treated as a first lien mortgage. Additionally, the regulation makes no distinction between types of second lien loans. In our case, most are closed end, five and seven year term loans that have credit risk reduced rapidly as the loan is repaid. Again, not adopting the Basel III 50% weights will limit access to credit and slow the economic recovery.

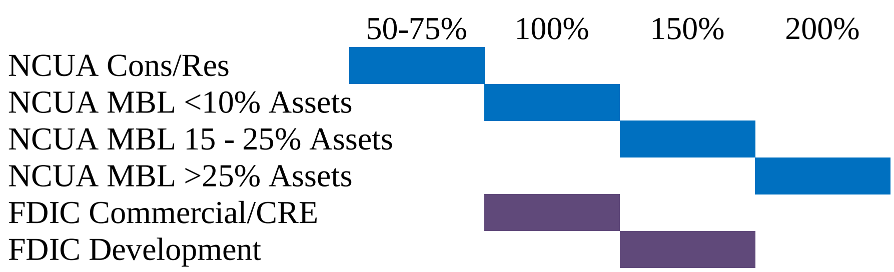
Florida Credit Union recommends that the Basel III risk weights for junior lien mortgages be adopted across the board.

Commercial Loan Lending:

Under the proposed NCUA regulation, the following table illustrates proposed risk weightings:

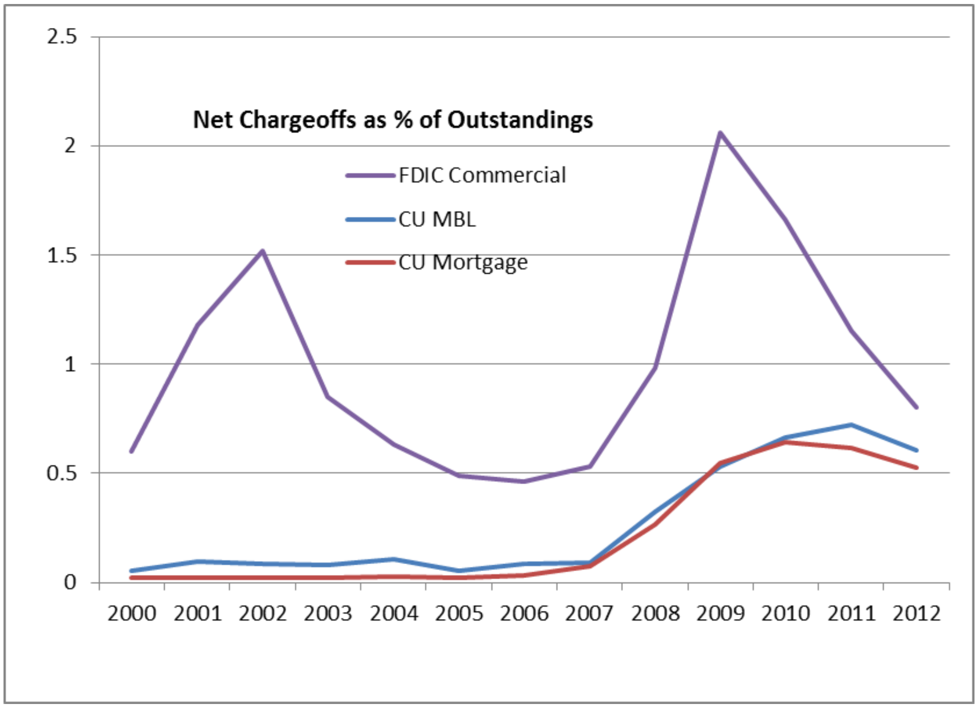
Total MBLs	Current MBL risk-weightings[51]—(converted for 8% adequately capitalized level) (percent)	Proposed MBL risk-weightings (percent)
0 to 15% of Assets	75	[52] 100
>15 to 25% of Assets	100	150
Amount over 25%	175	200

Risk Weighting



Under Basel III, the maximum risk rating for member business lending is 100% with the exception of high volatility commercial real estate loans which carries a 150% risk weighting. High volatility facilities are defined as a financial institution that finances the acquisition, development, or construction of real property other than 1-4 family residential property (Developers). NCUA seems to be strongly discouraging growth in this area due to the high risk weighting associated with percentage of assets in MBLs. Again, this should be managed through an institution's ALM, Member Business Loan and Concentration policies.

The banking industry has been immersed in commercial lending and does not see a need for such an intense risk rating on this asset class. FDIC regulated institutions have an unlimited ability to hold commercial loans on their books. The proposed regulation seems to be based on historical losses within a small group of credit unions; NCUA is unfairly impacting all credit unions and adversely controlling future credit union commercial lending endeavors. In fact, when you look at MBL performance long term, across all financial institutions, performance indicates these are low risk loans. The table below shows the current performance of MBLs in banks and CUs. It is important to note that community banks have no limit on the percent of their assets that may be in commercial loans. It is also important to note that current NCUA commercial lending regulations are far more conservative that the FDIC. Examples include: construction loans are limited to 15% of net worth, loan to value ratios are 80% versus 85%, and credit unions are limited to $100,000 in unsecured loan size where banks have no such restriction. This regulation effectively limits commercial loans to 15% of assets in credit unions, negating a key benefit of the "Low Income Designation" for credit unions. This proposal would limit the ability for businesses to access credit, causing a decrease in economic growth in America.



Florida Credit Union recommends that the Basel III risk weightings of 100% apply to commercial loans. Clearly, risk weighting commercial loans twice the credit card loan category is unjustifiable!

Loans Held for Sale:

In the NCUA proposed regulation, loans held for sale are risk weighted at 100%. Under Basel III in the interim final rule, these are weighted at zero as long as they are sold in 120 days. These assets are more of a receivable than a loan.

We recommend the Basel III risk weighting of zero as long as they are sold in 120 days.

Credit Conversion Factors (CCF):

The CCF converts the amount of a free credit line and other off balance sheet transactions. The balances of the pool are multiplied in the following order:

(Balance) X (CCF Percent) X (Proposed Risk Weight) = Risk based asset by pool.

Under the proposed NCUA regulation, the following table is proposed:

	Proposed CCF (percent)	Proposed risk-weight (percent)
Unused MBL commitments	75	100
MBLs sold with recourse	75	100
First mortgage real estate loans sold with recourse	75	50
Other real estate loans sold with recourse	75	100
Non-federally guaranteed student loans sold with recourse	75	100
All other loans sold with recourse	75	75

Under Basel III, the loan type is not a factor in determining the risk weight. The length of the line determines the risk weight. Below are the Basel III factors:

U.S. Basel III Final Rule
Standardized Risk Weights

- **0%** for the unused portion of a commitment that is unconditionally cancellable by the banking organization
- **20%** for the amount of a commitment with an original maturity of one year or less that is not unconditionally cancellable by the banking organization
- **20%** for self-liquidating trade-related contingent items, with an original maturity of one year or less
- **50%** for the amount of a commitment with an original maturity of more than one year that is not unconditionally cancellable by the banking organization
- **50%** for transaction-related contingent items (performance bonds, bid bonds, warranties, and standby letters of credit)
- **100%** for guarantees, repurchase agreements, securities lending and borrowing transactions, credit-enhancing representations and warranties that are not securitization exposures, financial standby letters of credit and forward agreements

Under Basel III, most consumer credit union open end loans would be at 0% risk ratings versus the NCUA proposal of 50-100%. This continues to gives an unfair advantage to the banking industry.

Florida Credit Union recommends that NCUA adopt Basel III risk weightings and eliminate the CCF percent be consistent with Basel III.

Federal Reserve Balances:

Cash held at the Federal Reserve is held with a 20% risk weight under the NCUA regulation. Basel III recognizes the Federal Reserve as having the backing of the full faith of the government, and assigns a zero percent risk weight.

We recommend adopting the Basel III risk weighting of Federal Reserve balances at 0%.

Investments:

Under the proposed NCUA regulation, the following table is proposed:

TABLE 7—PROPOSED RISK-WEIGHTS FOR CASH AND INVESTMENTS

Item	Proposed risk-weight (percent)
Cash on hand	0
NCUA and FDIC issued Guaranteed Notes	0
Direct, unconditional U.S. Government obligations	0
Cash on deposit	20
Cash equivalents	20
Total investments with WAL ≤ 1-year	20
Total investments with WAL >1-year and ≤ 3-years	50
Total investments with WAL >3-year and ≤ 5-years	75
Corporate credit union nonperpetual capital	100
Total investments with WAL >5-year and ≤ 10-years	150
Total investments with WAL > 10-years	200

Again, NCUA appears to be attempting to control interest rate risk on balance sheets through this proposal. With Basel III, all investments are weighted at 20% regardless of maturity. For many credit unions with low loan to share ratios, investments are a significant portion of their balance sheet. This proposal will significantly impact their ability to go beyond a five year investment. Diversification of investments should be in place in institutions today, based on their investment policy, ALM policy, and management controls. If Basel III does not risk weight investments this heavily, why does NCUA feel this is necessary?

Florida Credit Union recommends NCUA adopt Basel III 20% risk weightings for investments.

Goodwill:

Goodwill means an intangible asset representing the future economic benefits arising from other assets acquired in a business combination (merger) that are not individually identified and separately recognized. Under the NCUA proposed regulation for risk-based capital, credit unions will be required to deduct Goodwill from Capital. This requirement is the same under Basel III with regard to tier one capital; however, it seems this would have a very negative impact on potential credit union future mergers.

Allowance for Loan Losses:

In the NCUA proposed regulation, the ALLL addition to the numerator would be limited to only 1.25% of risk weighted assets. Due to the already increased risk weight associated with delinquent loans, and the proposed ALLL FASB standard regarding ALLL, the limitation should be removed from the current proposal. The proposed FASB standard would require an institution to hold in ALLL expected losses over the life of the loan at the time of inception. Today credit unions hold 12 months of historical losses on average, this would require credit unions to hold approximately 36 months of expected losses in ALLL. We acknowledge this proposal has not been finalized by the FASB.

Individual Minimum Capital Requirements:

Florida Credit Union is extremely concerned regarding the regulator's ability to determine how much a credit union is required to maintain in capital on a subjective basis. A predefined calculation gives a credit union the ability to manage their balance sheet appropriately based on predefined limits. This part of the regulation could potentially place a "well-capitalized" institution into any bucket, without the ability for the institution to prepare with only a 30 day possible rebuttal process. **This individual determination of the risk-based capital regulation needs to be removed from the proposal.** Regulations should be clearly written so both regulators and credit unions are required to follow them, not just credit unions.

Risk Based Capital Does Not Apply to Credit Unions Under $50 Million

Our position is that the final capital regulation must be applied to the entire industry, regardless of size. Not doing so is a mistake. Hopefully, most credit unions under $50 million will grow beyond that point. If they are not subject to the capital regulation, they will be in for a rude awakening when they reach $50 million. This situation is further compounded by the number of credit unions in this group that have received the low income designation. Exempt from the capital regulation, they would move from having no commercial lending caps, including commercial loan participations, to having a cap that could immediately become problematic in terms of regulatory compliance.

Scenario Analysis:

Florida Credit Union analyzed our institution based on risk-based capital in effect today, the proposed risk-based capital by NCUA, and Basel III capital on the FDIC side. The outcomes shown below illustrate how Florida Credit Union would look in certain strategic areas, to determine how this new proposal would affect us. CUNA's risk-based capital calculator was utilized to compute the hypothetical scenarios.

Today FCU's risk-based capital under the new proposal would be 15.11%. This would be considered well capitalized under the new NCUA risk-based capital regulation. Our capital to asset ratio is 10.72%, which is still deemed as "well capitalized" under PCA.

Under a five year asset growth rate of 10% per year and a 1.25% ROA with the outlined assumptions, the result would be the following under the new proposal and Basel III.

Scenario 1: Growth in commercial lending increased to 25% of assets, and decrease in auto lending for the same ratio, would put FCU at a 12.52% risk-based capital under the new proposed regulation. This is still classified at "well capitalized". If we utilized Basel III with the same assumptions, it would be a 14.10% risk-based capital ratio, or 12.62% higher than the NCUA proposed regulation.

Scenario 2: If we were to grow in commercial loans up to 25% of assets from 8.6%, and mortgage loans up to 25% of assets from 15.3%, the result would be 13.02% which is well over the "well capitalized" threshold under the proposed rules. However, under Basel III, the risk-based asset calculation would be 15.34%, or 17.82% higher than the NCUA proposed regulation.

Scenario 3: If we were to grow first lien mortgage loans up to 35% of assets with no commercial growth, the result would be 14.73% risk weight. Under Basel III, the risk weighting would be 16.55%, or 12.36% higher than the proposed NCUA regulation.

Scenario 4: If we were to grow member business lending to 39% of assets and reduced our mortgage and auto loan portfolio growth, our risk-based asset calculation would be 10.56% which is just barely well capitalized. However, under Basel III the result would be 15.19%, or 43.84% higher than the proposed NCUA regulation. As you can see, this asset class is the most affected under the comparison of the two methodologies. The third tier of the NCUA proposal exceeding 25% of assets in commercial lending at 200% versus the 100% in Basel III severely affects the overall outcome.

In summary, NCUA has proposed a regulation that is extremely unfair to the credit union industry. The risk ratings give an unfair advantage to the banking industry, especially with regard to mortgage and commercial lending. The Basel III committee has created guidelines that will be used domestically by FDIC and OCC as well as internationally. Why does NCUA feel the need to be more stringent on the capital risk weighting requirements? Please revise the proposal to ensure a more equitable competitive industry**. We recommend NCUA adopt Basel III.** When the regulation would be enacted with the use of Basel III assumptions, credit unions would still be required to hold more capital than banks until the 2019 phase out period ends.

Sincerely,

Mark N. Starr
President/CEO