St. Jean's CREDIT UNION
Massachusetts' First Credit Union

MAY19'14 PM 2:03 BOARD

May 13, 2014

Mr. Gerald Poliquin
Secretary to the NCUA Board
1775 Duke St
Alexandria, VA 22314

RE: Comments on Proposed Rule: PCA-Risk Based Capital

Dear Mr. Poliquin:

St. Jean's Credit Union appreciates the opportunity to comment on the agency's Proposed Risk Based Net Worth Regulation. St. Jean's is a $154 million well-capitalized community credit union serving over 15,000 members in three counties of Massachusetts. We have been in existence for 103 years and remain committed to serving the changing needs of our membership.

As a credit union that carefully measures risk to ensure safety and soundness, we certainly understand and support the need for a well-balanced set of capital standards for credit unions. The 7% well capitalized standard has served the industry well for many years, but we agree that now is the time for a change.

However, we also believe we must have an effective framework to serve the financial needs of our membership. The current proposal creates serious concerns for our credit union and will hamper our ability to grow and serve our membership. If this rule is adopted in its current format, it would result in a less workable capital standard, putting the credit union charter at a competitive disadvantage in the marketplace. When compared to Basel III, this proposed rule requires credit unions to have a significantly higher amount of capital than banks, which penalizes credit unions despite an overall low-risk profile compared to banks. On behalf of St. Jean's Credit Union, I respectfully recommend the following changes to the proposal:

• The risk based percentages to determine the different levels of capital at each credit union should be consistent for all credit unions. The ability for an examiner to use discretion to increase capital requirements above 10.5% will make it very difficult, or virtually impossible, for Management and the Board of Directors to effectively manage risk. Managing to a concrete regulatory capital number is critical to the strategic positioning of our credit union. The ability

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for an arbitrary or inconsistent capital number to be imposed by an examiner should be removed from the proposed rule.

• Any additional capital requirement on top of a statutory PCA requirement only serves to increase the regulatory burden on credit unions. If this rule is adopted, there will be two capital measurements: the PCA regulatory standard of 7% and the Risk Based Capital requirement of 10.5%. Which standard becomes the primary measurement? If a credit union is well capitalized on one ratio but not the other, which ratio will be used? We suggest that if a credit union is well capitalized on both measurements they should receive blanket waiver authority on fixed assets, personal guarantees requirements on business lending, and longer examination cycles. Credit unions that fall below the Risk Based Capital requirement that are above the 7% PCA requirement must be given ample time to restore the ratio. We would suggest a minimum of three years to improve the ratio. Whatever decision the NCUA makes on this issue, it is imperative that there be clear direction on when the credit union would be subject to PCA.

• Consideration should also be given to lower the Risk Based Capital requirement to be well capitalized from 10.5% to 9%. This would give a 200 basis point cushion above the 7% PCA standard and be in line with the requirement placed on community banks by Basel III. Additionally, we respectfully request that the NCUA Board consider lowering the risk based capital requirement for low income designated credit unions by 100 basis points to 8%.

Regarding, the individual weightings, we respectfully request the following changes:

1. Federal Agency Securities that are available for sale should be weighted at 0% not 20% as proposed. St. Jean's has been purchasing Federal agencies at our credit union for over 25 years through many interest rate cycles and have never suffered a loss. Available for sale securities are market to market through capital on a monthly basis, and a 20% basis point reduction would be an additional adjustment on top of the market value adjustment. Hold to maturity market fluctuation is disclosed on the 5300 and should be used as the adjustment rather than a weight of 20%. If a weight of 20% is in effect, we will reduce the amount of agency investments in our portfolio and purchase alternative investments that are risk weighted at 0%. This will further decrease our margin and lower ROA. When comparing overall investments to Basel III this proposal is much more aggressive. Credit unions, especially Massachusetts State Chartered Credit Unions, have limited options when choosing investments. Considering that the highest risk rating required by Basel III is 20%, St. Jean's respectfully recommends an overall weight on other investments of 20% regardless of the maturity.

2. Any adjustable rate Loan including 1st and 2nd Mortgages should be separated from the proposed matrix. The risk percentages should be lowered as these loans re-price with the market and should not exceed a 50% risk rating. St. Jean's is making these loans to our

members and the demand has been very strong. Applicants are qualified utilizing an interest rate above the introductory rate and re-price with any rate fluctuation. Credit unions located in the Northeast have been mortgage lenders since their creation and have managed the risk appropriately.

3. Delinquent Consumer Loans should be not be weighted above 100%. When a consumer loan becomes a reportable delinquency GAAP requires a specific reserve to be included in the allowance for loan loss. Currently, we specifically reserve from 25% to 100% of delinquent consumer loans. The amount of specific reserves should be deducted off the principal balance before the weight is applied. If the entire balance of these loans is weighted there will be a double posting on capital as the allowance increase is passed through an expense on a monthly basis. The same is true for TDR's where there is a specific reserve booked based on cash flows over the life of the modification. The specific reserves should be used as the weight rather than 100%. Performing consumer loans secured by Auto Loans should not be combined with Unsecured Consumer Loans. Secured Consumer Loans should have a risk weight of 50% as opposed to 75%.

4. Member Business loans should be the same as Basel III at 100%. Credit unions are held to a much higher standard than banks when making business loans and would be penalized as a result of this rule. Our strategic plan calls for the increase of our business loan portfolio. However, given the proposed weightings, we would consider slowing the growth in business loans which would be a detriment to our members and the communities that we serve.

5. Corporate Credit Union Capital should be risked rated at 100%. We were one of the credit unions that lost capital at our corporate during the crisis. We lost 100% of our investment and were never responsible for any additional loses.

6. Investment in CUSO's should not exceed a 100% weight. The proposed weight at 250% will stifle credit union collaboration and investment in business that will provide value to the membership. We are considering starting a CUSO to help smaller credit unions with operational issues and would not consider this type of investment with a risk rating above 100%.

7. Mortgage servicing rights are independently valued and a reserve is posted as a reduction to income if the valuation is below book value. A weight of 250% is excessive and should be reduced to 100%.

In order to get a better understanding of a credit union's complete risk profile, we urge the NCUA to consider weighing the liability side of the balance sheet by weighing both core and time deposits. Time deposits gain in value when rates rise and should be considered as an increase in Capital for the Risk Based Capital calculation. Consideration should also be given to core deposits as they also have a value above book and remain on the balance sheet regardless of rates. As a suggestion, the weights applied could mirror the investment weights.

The proposed rule appears to penalize credit unions when compared to Basel III due to the over emphasis on concentration and interest rate risk. Using the calculator on the NCUA website, St Jean's Risk Based Capital is 13.4% reducing our buffer to well capitalized by $2,000,000. When compared to Basel III the ratio is 16.3%. If this rule is adopted in its current form it will certainly give credit unions the motivation to consider converting to a bank charter which will ultimately cause credit union members to have less choice in the market place.

Lastly, we respectfully request that the agency consider an effective date of December 31, 2017. Requiring credit unions to implement this rule with only 18 months of preparation does not allow credit unions sufficient time to strategically adjust their balance sheets.

Thank you for the opportunity to comment.

Respectfully submitted,

C. David Surface

C. David Surface, President & CEO

cc: David Cotney, Massachusetts Commissioner of Banks
Senator Elizabeth Warren
Senator Edward J. Markey
Congressman John F. Tierney
Paul Gentile, Massachusetts Credit Union League