SchoolsFirst
FEDERAL CREDIT UNION

May 20, 2014

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

Re: Proposed Rule – Prompt Corrective Action—Risk-Based Capital

Dear Mr. Gerard Poliquin:

I am writing on behalf of SchoolsFirst Federal Credit Union, which serves school employees and their families in Southern California. We currently have more than 600,000 Members and $10.2 billion in assets. SchoolsFirst FCU appreciates the opportunity to provide comment and feedback on the NCUA Board's proposed rule regarding Prompt Corrective Action—Risk-Based Capital.

The NCUA Board is proposing to revise and replace NCUA's current PCA rules, which include a new methodology for computing NCUA's risk-based capital measures. While we understand the objective is to be more consistent with risk-based capital measures used for corporate credit unions and other Federal Banking Regulatory Agencies, we feel there should be minimal deviation from existing risk-based capital programs since they have been proven to work.

As currently written, we do not support this proposal, as it is detrimental and will have negative implications for the credit union movement creating a market disadvantage when compared to other financial institutions. There is no need to apply higher capital ratio levels or risk-weights on credit union loans and investments, since credit unions pose less of a threat to the economy in comparison to banks. This rule will be imposing a competitive disadvantage to credit unions by requiring such high risk weights. Consideration should be given to credit unions based on proven low delinquency rates and strong, long term, Member relationships.

We respectfully provide our opinions, feedback, and recommendations to address the following items within the proposed rule.

Definition of Complex Credit Union

The NCUA has provided contradictory definitions of what is defined as a "complex" credit union. This proposed rule defines a "complex" credit union as a credit union that is over $50 million in assets. But the NCUA has also defined a "complex" credit union in the derivative's regulation to be $250 million in assets. We feel that this definition should be consistent specifically across all NCUA regulations, while considering the complexity of smaller credit unions. In addition, the FCU Act includes other factors besides assets when defining a "complex" credit union. A benchmark should be set to define what asset size is considered "complex", regardless of the proposed rule. The impact of any new ruling or requirements on a small, less complex, credit union is tremendous due to the lack of manpower and expertise on hand in comparison to larger credit unions.

Implementation Period

An 18 month implementation timeframe to comply with these rules is too small of a window to implement adequately. We recommend the NCUA consider, at a minimum, a 5 year phase-in to implement these

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rules as banks were given when implementing Basel III. This will allow credit unions ample time to comply with these rules, while the NCUA provides necessary monitoring tools until the rule's effective date.

Prompt Corrective Action

Currently under PCA, the credit union has up to 2 years to work on a plan to bring the ratio to at least adequate status. In the event a credit union fails to uphold the minimum risk-based capital ratio, the proposed rule should allow credit unions up to 5 years to be phased back into capital ratio adequacy due to the inability to raise capital as quickly as banks.

Public Disclosure

We also want further clarification on the NCUA's intent to publically disclose credit union's risk-based capital ratios. While we may not be adversely impacted by implementation of the Risk-Based Capital Ratio, we do have a concern about misinterpretation and potential negative perceptions of this data by the public.

Allowance for Loan Loses

The limitation of 1.25% on the allowance for loan losses calculation is acceptable; however, the NCUA will need to reconsider this measurement once new FASB rules go into effect. If the FASB proposal, which currently includes basing the allowance on a current expected credit loss model (CECL), is approved, the impact could increase the allowances significantly, thereby potentially creating duplicate "reserves" in capital. In addition, the increase to the overall allowance contributions will considerably impact credit unions' net worth.

National Credit Union Share Insurance Fund (NCUSIF)

The NCUSIF should not be deducted from the Risk-Based Capital Numerator. We recommend it is treated as a deposit and not an expense for purposes of this calculation, considering it would be payable to the credit unions if they were to leave the NCUSIF and convert to private insurance or to a non-credit union charter.

Federal Reserve Deposits

Deposits that credit unions have with the Federal Reserve are included in the Due From banks category and as such, are 20% risk weighted. We believe that cash held at the Federal Reserve Bank should be included in Cash and hold a zero risk weighting.

Delinquent Loans

The proposed rule defines delinquent loans as loans that are 60 days or more past due and loans placed on nonaccrual status; however, existing financials institution industry standards allow up to 90 days. Absent substantive reason for the difference other than credit unions would not be required to change delinquency reporting in the call report, we recommend, for the purpose of this rule, the definition of delinquent loans is changed to 90 days. In addition, we believe that if delinquent loans 90 days or more have been impaired to a fair value, these loans should be classified at a 50% risk weighting.

First Mortgage Real Estate Loans

The definition of a first mortgage reflects a qualified mortgage; however, credit unions do not always fund mortgage loans limited to 30 years. We recommend extending the loan term for this definition to 40 years. Per the risk-weights proposed, a 10 year mortgage is just as risky as a 30 year. Loans with shorter terms should be assigned a lower risk-rate. We recommend the following:

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Proposed Risk-Weights for First Lien Real Estate Loans	
Term	Proposed Risk-Weight
15 years or less	25%
>15 years	50%

Also, no consideration is given on the risk-weight for first-lien real estate loans that have mortgage guarantee insurance. Since mortgage guarantee insurance minimizes the risk, loans with this type of coverage should be given a lower risk-weight. We recommend mortgage insurance loans are included in the 15 years or less tier for first mortgage real estate loans, as proposed above. The rule should also factor a lower risk weight when these assets have mitigating hedging strategies taking into consideration that credit unions currently manage their own level of concentration risk per NCUA requirements.

Troubled Debt Restructured Loans (TDRs)

The proposed rule states if you have modified a loan you cannot apply a 50% risk weight to first-lien real estate loans. This would then place all TDRs at a 100% level. Unfairly, the rule requires credit unions to assess for modified loans twice; 1) when rewriting the loans to fair value and 2) applying such high risk-weighting. We recommend that TDRs be eligible to be categorized at 50% risk-weight due to the fact that once the credit union has restructured and rewritten the loan under the modified terms and the loans book value is at fair value, the loan is no longer a risk. Failure to address this would reflect negatively on TDRs as a whole and could cause limitations on credit unions willing to restructure or modify loans for Members.

Loans Held For Sale

A 100% risk weighting should not be applied for loans held for sale when we have a commitment to sell. These are stated on the balance sheet at fair value. As such, we recommend a 25% risk-weighting.

Credit Union Service Organization (CUSO)

We feel that the 250% CUSO risk rating is excessive. We are recommending that consideration be made to lessen this risk rating to 100% since GAAP requires you to evaluate the asset for potential impairment. Also, the majority of CUSOs are not consolidated; they are LLC, which provides limited liability. In the event there was an operational issue, the CUSO would not impact the credit union because of the protections offered under an LLC formation. Furthermore, given the new CUSO requirements which take effect next month, the NCUA will have greater visibility into credit union' CUSO investments which will, by the very rationale expressed in the CUSO rule, reduce the risk exposure to credit unions since the NCUA will be able to take remedial action prior to a CUSO activity causing a material loss to a credit union.

Definition of Total Assets

The definition of Total Assets allows for credit unions to elect one of four measures of total assets. However, we propose only one measurement method to be used by all credit unions to maintain comparability. We also recommend that the credit union's total assets be measured by the average of the month-end balances over the three calendar months of the applicable calendar quarter, which would match against the quarter's earnings.

Definition of Appropriation for Non-Conforming Investments

We request further clarification as to what the NCUA defines as Appropriation for Non-Conforming Investments as stated in § 702.104(b)(1) Capital Elements of the Risk Based Capital Ratio Numerator.

Losses Not Reflected in the Risk-Based Capital Ratio Numerator

Under §104(b)(2) Risk-Based Capital Numerator Deductions, further clarification is needed of what is considered as Identified Losses Not Reflected in the Risk-Based Capital Ratio Numerator. The examples given; shortages in the ALLL, underfunded pension accounts, and unsupported valuations of bond claim receivables do not provide much detail.

Investments

Investments should not be categorized by maturity date. We strongly recommend that the investments are grouped by type of investment similar to current OCC rules; which have government issued guarantee (such as treasuries) at 20% and everything else at 50%. In addition, the rule needs to clarify those investments available for sale need to be adjusted to reflect book value before fair value adjustment and the risk weight application.

We recommend §702.105 Weighted-Average Life of Investments is removed. Ultimately this section states that regardless of the risk-weight capital results, the NCUA can impose additional capital requirements as they deem fit. This seems subjective and should be fully eliminated from the rule, and instead refer to Part 747 of the NCUA Regulations to address this area.

Member Business Loans

We recommend Member Business Loans mirror OCC rules and have only one risk-weight of 100%. This risk weight percentage mirrors OCC rules and standards.

Mortgage Servicing Assets

We consider the mortgage servicing assets' risk-weight excessive at 250%, since, per GAAP, these assets are required to be evaluated for impairment. We recommend mortgage servicing assets are given a much lower risk-weighting of 100% since the risk has already been reduced by evaluating for impairment.

Foreclosed and Repossessed Assets

Credit unions are already considering credit risk with foreclosed and repossessed assets when they are reduced to fair value and moved from the loan portfolio to other assets. We propose a 50% and not 100% risk-weight since risk has previously been accounted for by reducing balances to fair value.

CAMEL Rating

Additional information is needed with regards to how this new risk-based capital ruling will impact CAMEL ratings. The rule does not clearly outline the details of any potential changes. Although, on the surface it appears the risk-based capital ratio impacts only Capital Adequacy we request further clarification on the potential effects to other key areas such as Assets Quality, Management, Earnings, and Liquidity/Asset-Liability Management.

Consistency Amongst Rules

Further clarification is needed to determine how the Risk-Based Capital Rule is going to align with the Capital Planning and Stress Testing Rule. As it stands now, they do not seem to coincide. We recommend the NCUA issue an analysis to include areas of overlap and address contradictions.

Summary

We appreciate your consideration to our perspective and recommendations to the areas addressed above. We understand the NCUA's mission to ensure the safety and soundness of federally insured

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credit unions. We feel that the above comments and recommendations will provide the NCUA a better understanding of the overall impact to credit unions prior to finalizing this proposed rule. We would like to request for the NCUA to issue an additional Notice of Proposed Rule Making prior to final implementation to allow credit unions an opportunity to provide comments based on any revisions or updates decided upon. We ask you consider these recommendations and changes to allow for a more seamless process as we continue to adhere to the ongoing changes within our ever evolving industry. In conclusion, if the NCUA wants to apply a Risk Based Capital requirement, we suggest mirroring their proposal to the existing approaches applied in the banking industry instead of re-creating a new system that could make the credit union movement totally uncompetitive in the market. Furthermore, we suggest that this new rule, once finalized, is used only for reporting purposes over the next five years providing credit unions, as well as the NCUA, with a reference framework before full implementation.

Sincerely,

Francisco Nebot
Senior Vice President, Chief Financial Officer
SchoolsFirst Federal Credit Union

Cc: Credit Union National Association (CUNA)
California/Nevada Credit Union League (CCUL)

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