NorthStar
CREDIT UNION
Focused on your future.

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May 20, 2014

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

Dear Mr. Poliquin:

Please accept the following comments on the proposed amendments to 12 CFR parts 700, 701, 702 et al., in reference to Prompt Corrective Action – Risk Based Capital.

I am writing on behalf of the NorthStar Credit Union Board of Directors, management team, and credit union members. We appreciate the opportunity to provide comment on this very important proposal as it will likely shape the credit union landscape for years to come. We support the implementation of a risk based capital structure, but we have very strong reservations regarding the considerably higher risk weightings proposed for credit union assets vs. what is in place for banks. Please note that under both the current and proposed measures NorthStar Credit Union remains within the well capitalized category. We will, like most credit unions, suffer a reduced cushion over the "well capitalized" benchmark. As a result, we view the proposal as written, to be yet another constraint upon our ability to deliver competitive products and services to our members.

We strongly question the need for the aggressively high risk weightings proposed on credit union assets especially when considering that the "financial crisis" was created and born by the for-profit banking community. Research shows that over the period from 2007 through 2013, the FDIC incurred over 8 times the deposit insurance losses per $1,000 of insured shares than the NCUSIF. In spite of that information, the proposed risk weightings to be applied against credit union assets will cause us to hold considerably more capital than a for profit bank. This simply does not make sense.

The "one size fits all" nature of the proposal fails to recognize individual credit union performance within various types of lending. It simply sets increased reserve requirements based upon arbitrary % of asset levels by product line. Has any consideration been given to past performance, loan to value metrics, interest rate types (adjustable vs fixed rate loans), credit quality, funding sources, etc.? The proposal seems to penalize credit unions that have been successful in certain product lines.

Truthfully, the proposed risk weightings appear to be more targeted to controlling industry competitiveness and growth, than to addressing any type of safety and soundness concerns.

The following comments are in relation to Table 6--Risk-Weight Categories

Categories 3, 4 & 5 relative first mortgage lending

Why would the fact that a credit union has exceeded a certain, somewhat arbitrary percent of total assets in first mortgages necessitate additional equity capital? This one size fits all approach takes no account of offsetting liabilities, fixed or variable rate products, credit quality, individual field of membership characteristics, or the credit union's historical success in first mortgage lending.

Categories 6 & 7 relative other real estate loans

Given the fluctuation in real estate values over the past few years, it is understandable why the 100% weighting has been assigned to subordinate real estate loans, however, the increasing risk ratings based on the outstanding % of total assets makes little sense, particularly when considering that allowance for loan loss accounting rules already require the assessment of specific loan classifications and resulting reserves against known and potential losses.

The proposed weightings appear to assume that all credit unions are collateral based lenders, and that any pre-grant underwriting is limited to appraised value. These excess weightings are very troubling to our credit union, and I suspect any credit union whose field of membership holds a high level of home ownership. How were the additional weightings derived? Is there mathematical justification supporting these additional capital requirements in terms of NCUSIF deposit insurance losses?

Once again, the one size fits all approach takes no account of offsetting liabilities, fixed or variable rate products, credit quality, individual field of membership characteristics, or the credit union's historical success in lending.

Category 7 relative delinquent loans

It seems inconsistent and duplicative to require additional equity reserves against delinquent loans when proper allowance for loan loss accounting already addresses anticipated losses via provision for loan loss expense. Similarly, it is unclear why the allowance for loan loss account is only applied up to 1.25% of outstanding loans. In spite of verbiage within the proposal to the contrary, credit unions that are conservative in the assessment and reserving of problem loans will be forced to make a choice between conservative loan loss accounting and capital management, when the end result will be unchanged....the loan in question will either perform or become a charge-off.

Categories 3 through 8 relative investments

Given the many items that credit unions can, and do have in place in place to mitigate and monitor interest rate risk, it seems illogical to place yet another one size fits all asset weighting to investments. The proposed weightings are excessive considering that permissible credit union investments are, for the most part, limited to U.S. Treasuries and Agencies. One might understand such high weightings being applied to excessive concentrations in long term investments, but not considering liquidity planning, investment philosophy (laddering as an example), or ALM systems is highly arbitrary. **Particularly concerning is that based solely on the term of the instrument, credit unions would be required to allocate between 2.5 and 10 times the amount of capital required of a bank for the same level of risk.**

Category 9 relative investment in CUSOs

NorthStar holds equity investments in three CUSOs, each of which provide great value to the organization, and to our credit union members. Each is a shared service entity allowing us to price competitively by sharing costs with other credit unions. Their operations present very limited risk while producing top line revenue, cost savings or both to the owning credit unions. The 250% risk weighting will slow innovation and unfairly penalize smaller credit unions that cannot cost justify certain products without cooperatively sharing resources and costs with other credit unions.

It would seem appropriate to classify the risk associated with any given CUSO rather than apply a broad brush 250% risk weighting. Consideration should be given to the services a CUSO provides, its financial condition, balance sheet composition, and legal form of incorporation. Requiring capital allocations of 20 to 25% of an investment is arbitrary and inconsistent with the associated risk. As an example, one of our CUSOs holds 98% of our equity investment in federally insured money market deposits, which under the proposal would require a risk weighting of 20%, but by virtue of the funds being held by a CUSO, would require a 250% risk rated capital allocation on our books. It would seem that additional analysis on this area may be warranted.

Exclusion of the NCUSIF deposit

We do not understand the rationale for this provision of the proposal. The deposit insurance capitalization deposit is the fundamental basis of the cooperative deposit insurance fund. To the view of many, it is the single largest reason that we have maintained the strongest federal deposit insurance fund for many years. To classify it as an "intangible asset" and not consider it as capital or an asset is illogical. Credit Unions have faithfully paid any required assessments over the years, and the full balance is supported by the NCUSIF balance sheet. It is fully refundable in the event of a conversion or liquidation, so to treat it as though it were neither an asset nor capital is absurd.

Simple mathematics tells us that reducing both the numerator and denominator by the same amount, has a dramatic effect on the resulting ratio. In this case, the elimination of the NCUSIF deposit will reduce NorthStar's RBC ratio by a full 95 basis points, an incredible 7.2%, thus becoming the equivalent of having written it off. Furthermore, one has to question whether at some point in the future this provision will become the basis of an argument that it no longer be considered under existing net worth ratio calculations.

Section 702.105 Individual Minimum Capital requirements

This section of the proposal is particularly troublesome. Essentially, for any reason, the NCUA in its sole judgment can abandon the strict parameters they are proposing and require whatever level of capital they deem appropriate, with no advance notifications or framework. Since there are no due process constraints or apparent independent appeal processes set forth, one can only assume that regardless of the situation, the examiners will be able to dictate the operational actions of all credit unions. This blatant second guessing of credit union boards of directors and management, for the most part, puts the NCUA in control of any credit union, at any time, for whatever reason the NCUA determines. **This section of the proposal is a perfect example of overreach at the highest level.**

The following summarizes our views on the proposal as currently written:

- **We support the idea of a risk based approach to the determination of capital adequacy, but feel the proposal goes too far in placing constraints that will make credit unions unable to compete, and will ultimately accelerate the rate of conversion to banks or alternative forms of deposit insurance**

- **The proposal will force credit unions to act like banks, not the financial cooperatives that we are**

- **The one size fits all formula is problematic since all credit unions are not the same**

- **Historical credit union performance vs that of banks strongly substantiates the value of the current capital adequacy determination system. Comparatively speaking, the NCUSIF share insurance losses do not justify the need for this regulation.**

- **The proposed credit union risk weightings are punitive when compared to risk weightings applied to bank assets.**

- **To disregard the NCUSIF deposit in the RBC calculations is disingenuous to the cooperative principles of credit unions**

We appreciate the opportunity to comment on this very important proposal. We hope that you will take these and the many other comments you have received into consideration before finalizing this proposal.

If adopted in its present form, this rule will forever redirect the focus and attention of credit unions away from our cooperative mission of providing affordable products and services into an environment where profitability is paramount simply to meet arbitrary capital allocations.

This will eventually make us all just another profit driven bank, and will not, in any way be in the best interest of the credit union consumer.

Sincerely,

Lloyd M. Fredendall
President/CEO