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May 22, 2014

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

Re: VyStar Credit Union's Comments on NCUA's Proposed Rule for:
12 CFR Parts 700, 701, 702, 703, 713 and 747 RIN 3133-AD77 Proposed Rule for
Prompt Corrective Action – Risked-Based Capital

Dear Mr. Poliquin:

Thank you for providing us an opportunity to respond to NCUA's Proposed Rule referenced above. On behalf of the Board of Directors and Senior Management of VyStar Credit Union, headquartered in Jacksonville, Florida we offer the following comments, perspectives and suggestions.

General Comments:

From our perspective, the proposed rule is unnecessary and we encourage NCUA to reconsider adopting and implementing it. If NCUA does move forward with it, we believe that some changes are appropriate and have provided some suggestions for NCUA's consideration. We appreciate NCUA asking for credit unions' comments on the proposed rule, and for reviewing and considering our suggestions.

Under the credit union version of Prompt Corrective Action (PCA) approved in 1998 when Congress amended the Federal Credit Union Act, the levels for adequately capitalized and well capitalized credit unions were set at 6% and 7%, respectively. Those were higher thresholds then and remain higher than the thresholds still in place for banks, which are 4% and 5%, respectively. As expressed in the letter dated May 7, 2014 to NCUA from former Senator Alfonse D'Amato, who Chaired the US Senate Banking Committee at the time the Federal Credit Union Act was amended to require the implementation of a system of prompt corrective action, it was not Congress' intent to have a dual risk-based system for credit unions as with banks. We hope NCUA will consider the points that Former Senator D'Amato expressed in his letter regarding why he does not think credit unions should have the type of risk based system being proposed. It is our understanding that a significant number of members of Congress, over 300 have expressed concerns with the proposal. Also, while there were a number of credit unions that experienced serious problems, and some failed during the great recession, many

members of Congress as well as consumers have openly expressed that credit unions managed themselves before and during that crisis in a manner that did not create the Great Recession. Accordingly, we question if the proposed rule is needed.

We recognize that NCUA wants to ensure that credit unions and the credit union system always operate in a safe and sound manner such that credit unions continue to successfully exist for the benefit of all consumers, and we strongly concur with that goal. However, we are concerned that adoption of this rule as presently structured will add unnecessary regulatory burden to many credit unions that are well managed and that it will eventually impact their abilities to continue to serve their members well, add new products and services, and compete effectively in the ever changing financial services arena.

Having expressed those points, if NCUA does continue to move forward with the proposal, in general we think the framework of the proposed rule is an improvement over the existing risk based net worth requirements. However, we suggest some changes to the existing proposal, if NCUA does move forward with adopting it. We have outlined those suggestions below.

The proposed rule seems ambitious in that it is trying to not only address credit risk but also risk from interest rates, asset concentration liquidity, and operational and market risks. Credit risk is somewhat quantifiable while many of these other risks can be quantified but the methodology used may be subjective at best.

In addition, various parts of the proposed rule seem to step outside of the intended scope of the framework and could potentially adversely affect credit unions' operations and ability to diversify in a competitive environment with other financial institutions.

Specific Comments on Risk-Weight Categories

The proposed rule for risk-based capital defines 10 risk-weight categories for assets. Some of the risk weightings seem appropriate. However, the following points are of concern with the identified proposed risk weights:

Risk-Weighting of Investments in Categories 2, 4, 7 and 8

A summary of the risk-weightings for investments appears in the table below and it shows the risk-weight category, risk-weight and maturity or weighted average life (WAL) criteria used for categorizing investments. These risk-weightings do not seem to reflect the spirit of this proposed rule because they assign risk-weightings solely based on maturity of cash flows. This would heavily skew the objective toward only addressing interest rate risk and market risk, and ignoring credit and liquidity risk.

Fundamentally, these risk-weightings ignore the interest rate characteristics of investments and whether the investment is fixed or floating rate.

A number of credit unions have been shifting investments toward floating rate instruments; they have now become part of the interest rate risk tool kit. A floating rate investment may have a similar weighted average life to fixed rate investments but the valuation, interest rate risk and market risk are significantly different because of the interest rate characteristics that are ignored by these proposed risk-weight categories.

In addition, these risk weightings would imply that credit risk does not count as they do not differentiate between agency, corporate or potentially high risk credit. Each of these different types of investments has their own unique liquidity and credit risk characteristics but they are being treated equally by these proposed risk-weight categories.

Risk-Weight Category	Risk-Weight	Maturity	weighted average life
2	20%	<3 months	NA
2	20%	NA	< 1 year
4	75%	NA	>3 years and ≤5 years
7	150%	NA	>5 years and ≤10 years
8	200%	NA	> 10 years

The proposed risk-weight categories for investments are a start. However, if the spirit of this proposed rule is as stated, then the general interest rate characteristics and credit also need to be factored into the risk-weighting. Investments should be categorized based on the general interest rate characteristics: fixed, floating or callable. The risk weightings for floating rate investments should be relaxed to some degree from those proposed for fixed rate and callable investments. However, floating rate investments should be categorized according to credit characteristics rather than maturity because by nature they are not subject to the same level of market and interest rate risk as a fixed rate or callable investment. Risk weightings for floating rate investments should be treated the same as investments with maturities less than 1 year with a 20% risk weighting. Investments with quarterly or annual resets should be treated in a similar manner to pure monthly floating rate investments.

An example of two similar collateralized debt obligations (CMO) will clarify this position. Given two CMOs with similar structures of cash flows and collateral both with 10 years until final maturity and similar prepayment rates, and weighted average lives but one is fixed rate and one is floating rate. While they are both CMOs with the same cash flow characteristics as measured by the proposed Risked Based Capital (RBC) weightings, they have very different interest rate and market risk profiles. These two investments, therefore, pose different risks and should not be treated the same for RBC purposes.

In addition, the proposed risk-based capital guideline interchanges the weighted average life of investments with the duration target for investments. This would appear to be either an error in terminology or a misapplication of the term duration. Weighted average life is widely understood to define the average time to receive back the principal from an investment. Using this concept, the weighted average life of an investment that returns all principal at maturity would have a weighted average life of the length of maturity. If it were a ten year investment, the weighted average life would be ten years. Similarly, for an amortizing investment such as a CMO the weighted average life would take into account the expected prepayment rate, which can materially shorten or extend the weighted average life. It is true that the Macaulay duration does approximate weighted average life. However, Macaulay duration is considered an out dated measure of interest rate risk and has been supplanted by effective duration. Effective duration would indicate that the effective duration for a bullet instrument approximates to one half the weighted average life. Weighted average life and effective duration are not closely related nor are they interchangeable terms. The CMO example above illustrates this point because the two CMOs could have a weighted average life of 7 years, yet the fixed rate CMO may have an effective duration of 3 years and the floating rate CMO an effective duration of 1 month, if it were a monthly floater. This illustrates that the correct definition of effective duration and weighted average life are two very distinct measures of interest rate risk and they are not interchangeable in assessing interest rate or market risk.

Risk-Weighting of Consumer Loans Secured and Unsecured in Category 4

Category 4 specifically addresses the risk-weighting of current and non-delinquent unsecured and secured credit, excluding member business loans and real estate secured loans. Given the focus of the different risks that are attempted to be addressed with this proposed risk-based capital rule, giving equal risk-weighting to secured and unsecured credit does not seem consistent. Clearly, many credit unions suffered credit losses in this loan category during the last recession. The biggest losses clearly came from unsecured credit because by definition there is no collateral securing the debt; accordingly, once in default, recoveries are generally very small, if existent. While secured loans did suffer losses during the downturn, the losses were not typically as great a portion of the outstanding loan balance as with unsecured loans because the underlying collateral could be repossessed and sold to at least partially recover losses. It does not seem consistent to give equal risk weighting to a secured and unsecured loan. While non-real estate secured loans are not necessarily riskier than real estate loans, it would seem more reasonable to split secured and non-secured loans and assign a category 3 risk-weighting, or lower to secured loans.

While the proposed rule addressed unused lines of credit for member business loans it is silent on unused lines of credit for unsecured consumer loans. If the intent is to address the six risks identified, then unused unsecured lines of credit (credit cards and unsecured lines of credit) should be included in a risk-weighting category such as 1 or 2, so that they are at least identified, but the rule should not penalize a credit union for having them. A similar approach to the one taken by the risk-based capital NPR for community banks

could give these unused lines of credit a conversion factor such as 10% and then include them as off-balance sheet contingent claims.

Risk-Weighting of Total Investment in Credit Union Service Organizations (CUSOs) in category 9

The proposed risk-weight category for total investment in CUSOs as category 9, which requires 250% risk-weighting, seems punitive, inconsistent with addressing the six different risk categories and misses the mark in generalizing investments in CUSOs. This proposed risk weighting for Investments in CUSOs unfairly penalizes credit unions for trying to diversify income opportunities in the face of declining net interest margins, threats of reducing amounts of interchange income, and general competition in the marketplace among financial institutions. Even credit unions with assets below \$10 billion have experienced reductions in interchange income because of deals networks have made with retailers to ensure the retailers still route transactions on their networks.

It would appear that risk-weight categories 9 and 10 are intended to dissuade credit unions from investing in CUSOs and mortgage servicing assets, and to be knowledgeable about their investments. With respect to the latter point, we have no argument. Clearly all credit unions must understand the characteristics of their investments. However, risk weighting investments in CUSOs at 250% seems arbitrary and punitive. It would seem more reasonable to classify CUSOs according to different business activities and place those investments into lower risk-weighted categories that are more commensurate with the actual business risk. A one size fits all approach to CUSOs with such a high risk-weighting would force many credit unions to reevaluate their CUSO operations and perhaps discontinue a value added service to members.

This proposed regulation treats all CUSOs as investments made by the credit union when this is not always the case. Some CUSOs represent co-operative ownership structures that did not require an initial investment such as the case with credit card servicer PSCU, Tampa Bay, FL. Similar structures exist with the CO-OP and CU24. PSCU is a co-operative that is owned by approximately 700 credit unions that have not paid in capital. The CUSO asset many credit unions carry on their books for PSCU merely represents cumulative patronage dividends generated by the CUSO that have been earned and under Generally Accepted Accounting Principles (GAAP) must be recognized and reported, carried as an investment or ownership in the CUSO, yet they have not been paid. These dividends may or may not be paid out to the credit union in the future but they do not represent a material financial threat to a credit union's balance sheet because PSCU has no financial recourse to the credit union if the dividends are never paid. If that were to occur, the impact to the credit union would be to write-off them off. Therefore, it does not be reasonable to treat this type of CUSO the same as other CUSOs with respect to capital requirements. These types of CUSOs should be treated as a short term investment with a 50% risk weighting at most. There needs to be some means to differentiate between an actual investment in a CUSO and earnings a credit union may receive from future payable patronage dividends.

Many services offered through CUSOs place credit unions on a more level playing field with banks. Competition and the need to diversify income are forcing many credit unions to look to CUSOs for additional revenue opportunities. With the decline in NSF fees, threats to interchange income and the abysmal interest rate environment that is eroding net interest margin, credit unions need CUSOs to diversify income in these challenging times.

Many credit unions offer insurance products and other services through their CUSOs. These types of operations typically pose little risk to the credit union system. The risk and business exposure in these types of operations are generally limited to the capital investment plus a small additional amount but not 250% of the investment.

By diversifying income and better meeting the needs of credit union members, CUSOs are a valuable entity to the credit union industry. The risk of these entities should not be so punitively measured with a category 9 risk weighting.

Risk-Weighting of Mortgage Servicing Assets in Category 9

The proposed risk-weight category for mortgage servicing assets as category 9, which requires 250% risk-weighting, seems excessive, inconsistent with trying to address the six different risk categories and counter intuitive to the mission of credit unions. Most credit unions take a very conservative approach to valuation, and the mortgage servicing asset is typically not that large relative to the credit union's balance sheet and not that volatile. While this type of risk-weighting might make sense for large banks that have opted into fair market value for mortgage servicing rights, credit unions typically do not have an asset with this same type of volatility and risk. Therefore, while the asset is relatively small it should not be categorized as a category 9 risk-weighted asset that requires 250% risk-weighting.

Retaining mortgage servicing rights is fundamental to the principles of credit unions whose mission it is to serve the financial needs of their members. Many other financial institutions sell mortgages with servicing released and these servicing rights become a valuable but volatile asset. Credit unions generally retain servicing and thus accumulate a mortgage servicing asset not for financial gain but to provide members with high quality service and the safety of knowing that their loans, while they may be sold, are still serviced by the credit unions that they trust. During the Great Recession, having held the servicing rights to mortgage loans enabled many credit unions to work directly with members impacted by the recession and help them remain in their homes with reasonable troubled debt restructures.

Proposed Risk-Based Capital Numerator

The proposed risk-based capital numerator does include allowance for loan and lease losses (ALLL) in the calculation of the numerator. However, the proposed rule limits ALLL to 1.25% of risk assets. This limitation is troubling in light of the recent financial crisis and high levels of losses and subsequent ALLL and given that the Financial Accounting Standards Board (FASB) is considering changing the methodology to one

based on expected loss that some fear will double or triple the size of ALLL. Because the spirit of the proposed RBC is to address a wide variety of risks, it would appear that limiting ALLL to 1.25% of risk assets ignores the fact that ALLL is a reserve for loan losses and should be considered as an integral part of the capital buffer in the event of adverse credit conditions. Limiting the amount of ALLL may perhaps encourage more risk taking by incenting credit unions to not fully or properly build ALLL. It might also encourage adverse behavior of credit unions releasing reserves too quickly in the midst of prolonged credit stress. This limitation should be eliminated and it should instead allow credit unions 100% of ALLL because these reserves are in fact a buffer for exactly what NCUA is trying to accomplish with risk-based capital: an economic buffer for adverse conditions.

105 (c) Standards for Determination of Appropriate Individual Minimum Capital Requirements

The spirit of section 105 (c) seems to be reasonable from a regulatory perspective, a pure mathematical model for RBC could potentially allow for excessive risk taking. Instead, some degree of NCUA discretion may be required to check individual risk. The unintended consequence of this section is to leave open the potential for examiners to punish individual credit unions for perceived risk that may be real or not real. It would seem more reasonable to provide very specific situations where additional RBC would be required and for very specific events. The proposal mentions potential problems with “liquidity, capital and other indicators of financial stability”. The situations and levels where a credit union is deemed to be financially unstable should be clearly specified. For example, the joint policy statement on liquidity risk very specifically mentions four different states of liquidity; levels 1, 2, 3, 4. Something should be crafted to integrate the liquidity risk with the capital levels by increasing RBC for each level or stage of liquidity risk into which the credit union transitions. At the very least, the last financial crisis taught many financial institutions about the wisdom of liquidity risk planning and the consequences of market factors. RBC should be another factor that is perhaps adjusted as the liquidity risk of the institution changes, but this should be clearly specified and not subject to interpretation by NCUA and field personnel with different experiences and therefore different interpretations of risk. While we have not experienced it at VyStar, we sometimes hear comments from credit unions who believe they have been ill treated by examiners. We fear the type of approach proposed has the potential to increase those types of perspectives and complaints. Accordingly, we recommend establishing more specific criteria for requiring higher capital levels in such situations.

Clearly, the standards for appropriate individual minimum capital requirements need a great deal more specificity in order to ensure fair and impartial implementation at the individual credit union level.

Proposed Capital Categories

The proposed capital categories define credit unions' net worth classification, net worth ratio and risk-based capital ratio. The levels of proposed risk-based capital ratios seem to be loosely tied to Basel but they lack any type of economic or financial justification. The 7% well capitalized level appears to be consistent with the current PCA guidance definition of well capitalized. However, the risk-based capital ratio of 10.5% or above seems less well grounded. It does not seem clear why 7% and 10.5% would be appropriate capital ratios for their respective measures. It is not clear if this implies that the difference is some type of implied economic buffer or some other intended measure. From an economic and financial perspective, it would seem that there should be some way to quantify the implied risk that the risk-based capital proposal is trying to preserve. In other words, is the risk-based capital cushion implying that in a worst case scenario, the difference between the net worth ratio and the risk-based capital ratio is 3.5% given 7% and 10.5% ratios, respectively? Does this imply that buffer is 50% of net worth given a 7% net worth ratio and the 3.5% buffer? Economically, the point of risk based capital seems to be to provide a more realistic measure of asset risk given the various risk factors. The estimated risk-based capital should be the amount of capital that would allow a credit union to absorb these various risks and still have adequate capital. If these are economic underpinnings of risk-based capital then a more rigorous approach should be taken to estimate the economic buffer that risk-based capital is intended to measure. The buffer should include identification of the associated risks and the weighting toward the economic buffer. The current risk-based capital ratio may be appropriate; however, without economic justification it is difficult to make this determination.

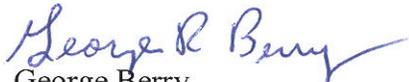
Conclusion:

The proposed rule has many elements that appear to be reasonable especially compared to the risk-based capital proposal for community banks. Most loans are treated more favorably in NCUA's risk-based capital proposal than they are as outlined for community banks. A number of areas are very similar to those required for community banks including the harsh treatment of CUSO and mortgage servicing rights. NCUA's risk-based proposal, however, treats investments much more harshly than the requirements for community banks. This letter has outlined all of these issues and it has made recommendations for changes and/or clarification on these different points. Again, we hope that NCUA will reevaluate the need to implement this proposed rule; however, if it does decide to proceed, we encourage it to revise the rule before it is finalized and implemented.

Ms. Mary Rupp
May 22, 2014
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Again, thank you for providing credit unions an opportunity to comment on this Proposed Rule and to offer suggestions for consideration. If you have any questions about our comments, please contact our President/CEO, Terry West at 904-908-2500.

Sincerely,



George Berry
Chairman of the Board
VyStar Credit Union

Cc: Board of Directors
Terry West, President/CEO
John Turpish, EVP/Chief Financial Officer
Rich Alfirevic, EVP/Chief Operations Officer
Daniel Mashevsky, Vice President Finance