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CME
FEDERAL
CREDIT UNION

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May 21, 2014

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

Re: Comments on Proposed Risk-Based Capital Regulation

Mr. Poliquin:

The management, Board of Directors and Supervisory Committee of CME Federal Credit Union (CME) thank you for accepting our response to the proposed risk-based capital regulation. Upon reviewing NCUA's proposed risk-based capital rule, CME would fall from being considered "well capitalized" under the current regulatory guidelines to being "adequately capitalized" under the newly proposed system. It is worth noting that CME, like many other credit unions within the industry, has maintained its "well capitalized" position despite the troubling economic conditions displayed during the recent recession. This begs the question, "Why is the administration proposing a change to the capital regulations at this time?"

The notion that all of the material risks (liquidity, interest rate, concentration, credit, extension) that are expected to be monitored by each credit union can be scrutinized by a national formula which applies arbitrary risk weights to different asset items is impracticable. In addition, if this formula does not reflect an acceptable level of capital, the rule proposes the examiners have the authority to determine a credit union's proper capital level. This rule in its proposed state would severely diminish the management's and Board's ability in making the financial and strategic decisions necessary for the credit union, and ultimately its members.

Investments

Breaking down the investment portfolio by years of maturity and placing risk weights on the different maturities may only address a portion of interest rate risk as it pertains to investments, but whether the investment is fixed or variable also has an impact on the interest rate risk which is not captured by the proposed rule. Approximately 80% of CME's investment portfolio is in adjustable rate mortgage backed securities, and of these investments, the majority are GNMA labeled which carry 0% risk weights as they have the full faith and credit backing of the federal government. In addition, the mortgage backed securities are all listed as available for sale and are being marked to market each month. NCUA needs to include factors to appropriately address any risk mitigation measures being conducted by credit unions when analyzing risks associated with investment portfolios.

If NCUA decides to measure the risks associated with investments by placing arbitrary risk weights on the different maturity levels, this system should not be set up to penalize short or medium term investments, but rather mirror that of the Basel III approach to risk-based capital. The following is a potential example of an alternative method of measuring the risks associated with investment portfolios:

Investments WAL < 5 years	20%
Investments WAL 5 to 10 years	75%
Investments WAL > 10 years	150%

This alternative method would capture interest rate risk concerns that may exist with longer-term investments.

The investment strategy taken by CME is one that maximizes yield, addresses interest rate risk and ensures a steady cash flow of repayments to mitigate liquidity risk. The effects of the proposed rule would certainly modify the credit union's investment strategy in which investment maturities may be much shorter and in fixed rate investments which could potentially result in lower yields, more interest rate and liquidity risk and less earnings negatively impacting gross capital.

First Mortgage Real Estate Loans

CME's first mortgage loan portfolio consists of both variable (45% of total) and fixed (55% of total) rate loan products. Of the fixed rate first mortgages, just over 75% are a 10 year loan product. The entire first mortgage loan portfolio consists of loans with an average FICO score of over 740 and less than 1% of the total first mortgages have been charged-off in the last five years. These exceptional facts can be attributed to sound underwriting standards, reliable collection efforts and a good local housing market. The risk weights being proposed on first mortgage real estate loans do not take these viable factors into consideration in order to reduce the amount of risk associated with CME's first mortgage loans.

If the newly proposed rule cannot utilize the mitigating factors mentioned above, then alternative methods to measure the risks involved need to be considered. At a minimum, first mortgage loans should be separated by variable rate versus fixed rate loans with lower risk weights associated with the variable rate loans and shorter term fixed rate loans in order to capture less interest rate risk as compared to a 30 year fixed rate first mortgage. In addition, a credit union should not be penalized for having a high quality, performing first mortgage loan portfolio. Risk weights should be lowered on first mortgage real estate portfolios that demonstrate strong performance through lower charge-off ratios.

Mortgage Servicing Rights

To help mitigate interest rate risk in the credit union's first mortgage real estate portfolio, CME sells the majority of its 15 and 30 year fixed rate first mortgage loans. However, in order to maintain a valued relationship with the member, the mortgage servicing rights are retained. Due to the high performance of the sold first mortgage loan portfolio, there is minimal risk associated with the mortgage servicing rights. Placing a weight of 250% on these assets is penalizing those credit unions that eliminate the interest rate risk of holding these same first mortgages. A reduction in the risk weight associated with the mortgage servicing rights is warranted.

NCUSIF Deposit

It is noted that the NCUSIF deposit is being deducted from Net Worth, therefore reducing the numerator in the risk-based capital calculation. We ask that NCUA reconsider this position as this leads one to believe that this deposit poses a risk to credit unions and if that is the case, then the deposit should be expensed rather than being capitalized as current methods instruct.

Implementation Period

Being categorized as an "adequately capitalized" credit union under the newly proposed risk-based capital regulation, it would be prudent to allow CME, and other similarly positioned credit unions, an extended period of time to reposition the balance sheet in order to move into the "well capitalized" category. A timeline of 18 months is not sufficient to reorganize and shift the balance sheet appropriately to address the items accordingly; a period of 36 months would be more practical. In addition, the call report data may need to be expanded to properly capture the information necessary to address any modifications to the regulatory risk-based capital formula. Although expanding the call report data may not be ideal, it may be necessary in order to gather the appropriate information to adequately address the risks to capital.

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We would like to thank NCUA for the opportunity to comment on the newly proposed risk-based capital rule and for taking our remarks into consideration when finalizing the risk-based capital regulations.

Respectfully Submitted,

CME Federal Credit Union

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