May 28, 2014

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

Subject: Comments on Proposed Rule: PCA – Risk-Based Capital

Dear Mr. Poliquin:

Security Service Federal Credit Union (SSFCU) has reviewed the subject proposed rule, and respectfully offers our comments for the agency's consideration. NCUA's focus on assuring Capital Adequacy in individual credit unions and the credit union system as a whole is appropriate and commendable. In general, we agree that an improved risk-based capital regime is necessary for the safety and soundness of the credit union movement, as well as to assure a strong and healthy National Credit Union Insurance Fund (NCUSIF); however, we strongly disagree with the rule as proposed, as it goes well-beyond necessity, and penalizes credit unions for being chartered as credit unions, thereby diminishing the long-term value of the credit union charter.

NCUSIF Performance and Financial Condition – Excellent

The performance and health of the NCUSIF is excellent, and does not require a risk-based capital regime of the scope and magnitude found in the proposed rule for natural person credit unions. While 102 credit unions failed during and following the worst economic crisis since the Great Depression, the NCUSIF, without question, *performed as designed* in handling natural person credit union problems. Certainly, losses were elevated, NCUSIF premium assessments were necessary, and NCUA staff was stretched to deal with credit union failures; however, the health and stability of the NCUSIF was *never in question*.

Financial stress caused by natural person credit unions, while unpleasant, proved quite tolerable. In fact, the NCUSIF equity ratio touched its 10-year low point in 2009 at 1.23%, quickly returning to the statutory equity limit of 1.3% during 2011, requiring insurance premium assessments in only two years: 10.27 and 12.42 basis points in 2009 and 2010, respectively. The 1.3% ratio continues through the date of this writing. Notably, $88 million and $95 million of NCUSIF equity was distributed to the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) during 2012 and 2013, respectively, to reduce the NCUSIF equity ratio to 1.3% for these fiscal periods.

The 1.3% equity ratio was attained and retained during a period of time (2009 through 2013) where total insured shares grew over 19%, indicating that equity growth was not only sufficient to return the equity ratio to the statutory limit based 2009 insured shares, but was more than sufficient to keep pace with continued healthy credit union share deposit growth experienced during the period.
As indirectly alluded to in NCUA media comments, extremely costly insurance losses were experienced and capital infusions were necessary during the recent economic crisis; however, natural person credit unions, those targeted and affected by the proposed risk-based capital rule, did not cause these

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extreme financial costs. That distinction goes to the corporate credit union system and the supervision thereof.

TCCUSF insurance premium assessments (compared and contrasted to NCUSIF premiums related to natural person credit union losses) were as follows:

	2009	2010	2011	2012	2013
TCCUSF	4.73	13.40	25.00	9.50	8.00
NCUSIF	10.27	12.42	0	0	0

Large share insurance fund losses, share insurance premiums, and infusions of capital were necessary because of corporate credit unions, not natural person credit unions. To allude to characterizations otherwise is misleading, at best.

Capital adequacy in natural person credit unions proved strong and true in the most-recent real-world stress testing scenario, and there is no reason to change the system to the extent proposed. Post-economic crisis: Capital in the natural person credit union system was overwhelmingly sufficient to handle natural person credit union losses, the NCUSIF performed as designed, and only 102 credit unions failed. Thus, the scope and magnitude of the proposed rule is simply unnecessary.

Prompt Corrective Action (PCA) "Well Capitalized" Requirement

We strongly oppose the 10.5% RBC ratio threshold requirement for the "well capitalized" PCA category.

Citing comparability to the FDIC's 8% Total Risk-Based Capital Ratio plus the FDIC's 2.5% Capital Conservation Buffer, which is expected to be fully implemented in 2019, the NCUA rationalizes implementation of the 10.5% threshold for a credit union to be considered "well capitalized."

FDIC's Capital Conservation Buffer limits certain types of payments, including dividends to stockholders, share buybacks, discretionary payments on equity capital, and discretionary bonuses. FDIC's rule authorizes a progressive schedule of such payments based on a Calculated Capital Conservation Buffer, so as to assure that capital is not paid to stockholders and investors in a manner that weakens bank capital structures.

Credit unions pay "dividends" that are the functional equivalent of interest on deposits in banks. Consequently, a Capital Conservation Buffer strategy is not applicable to credit unions, and is an inappropriate basis for supporting this approach when defining PCA categories for credit unions.

Furthermore and most importantly, irrespective of FDIC's Capital Conservation Buffer, FDIC's rule considers a bank with a 10% Total Risk-Based Capital ratio to be "Well Capitalized," and we respectfully request use of a 10% threshold for credit unions to assure comparability between the two RBC regimes.

"Must Consider All Material Risks" – Interest Rate Risk

Interest Rate Risk (IRR) is a material risk that must be measured, monitored, and managed with diligence. We recognize the agency's mandate, as well as their diligence in promulgating appropriate rules; however, in considering all material risks, as required by the Federal Credit Union Act, we respectfully disagree that IRR should be a major factor in assigning risk-weights to certain concentrations of assets.

First and foremost, while all agree that IRR is a material risk, we do not support the notion that it is (as quoted from the Federal Credit Union Act) a "material risk against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection." Few, if any, credit unions fail because of IRR. Rather, most credit unions fail because of one or more conditions that almost always include excessive credit risk and/or fraud, giving credence to the approach demonstrated in risk-based capital regimes for banks that do not consider IRR.

In credit union failures, underwater assets caused by interest rate changes and poorly managed IRR can elevate NCUSIF losses at liquidation; however, taking a liquidation approach to evaluating capital adequacy is simplistic and short-sighted, as 98% of regulated credit unions are "going concerns" not facing any foreseeable liquidation event.

Second, risk-weighting schemes in the proposed rule do not consider the liability side of the balance sheet, and as such, do not accurately and sufficiently quantify IRR to the extent that *any* risk weighting scheme is quantifiably or qualitatively supportable for the purposes of determining capital adequacy.

Well-managed credit unions diligently employ IRR modeling that exposes balance sheets to various interest rate scenarios, using conservative modeling assumptions. SSFCU does just that; however, the proposed rule gives no credence to our diligent use of NCUA-suggested methods of managing IRR.

Instead, SSFCU and other credit unions that use sophisticated modeling techniques are inappropriately included in an unsupportable one-size-fits-all approach, due to the fact that the liability side of the balance sheet is ignored, as are widely-accepted modeling techniques supported by NCUA.

For these reasons, we respectfully suggest that, like bank risk-based capital regimes, IRR considerations should not be part of the risk-based capital regime for credit unions. Additionally, we suggest the NCUA consider issuing general guidance regarding acceptable IRR modeling techniques and assumptions for credit unions, as well as attendant examination guidance for agency staff.

Section-By-Section Analysis

"Allowance for Loan and Lease Losses" (ALLL) – When calculating the risk-based capital ratio numerator, only the portion of the ALLL that is less than or equal to 1.25% of risk assets can be included. NCUA states that, "by establishing a limit in the amount of the ALLL included in the numerator, the proposed rule would provide an incentive for granting quality loans and recording losses in a timely manner."

We oppose the 1.25% limit for the following reasons:

- The proposed rule simply chooses to ignore the existence of capital for amounts in the ALLL that exceed 1.25% of risk assets, thus giving this form of capital absolutely zero value when calculating RBC PCA ratios.
- Management's adherence to Generally Accepted Accounting Principles (GAAP) drives funding of the ALLL, without any other influence.

- Creating an incentive for sound loan quality within the context of this proposed rule is inappropriate, as these rules are designed to quantify capital adequacy and PCA triggers.

Thus, we respectfully suggest including 100% of the ALLL in the calculation of the risk-based capital ratio numerator, since the ALLL is available to cover delinquent and other loans included in the denominator, many of which carry an elevated risk weight.

Investment Risk Weights – Risk weights for investments are based on the weighted average life (WAL) of each investment, where higher risk weights are assigned for longer WAL. Interestingly, the proposed rule assigns a zero risk weight to all U.S. Government-backed investments, thus appearing to indicate that government securities do not have IRR.

As discussed previously in this letter, IRR and related risks do not cause credit unions to fail, and well-managed credit unions diligently use sophisticated modeling techniques to model balance sheets under several stressed IRR scenarios. Consequently, we respectfully suggest that investment risk weights for credit union RBC rules be identical to those of banks, which do not include IRR considerations.

Residential Mortgage Loan Risk Weights – Risk weights for residential first mortgage loans are based on the concentration of such loans on the balance sheet, where higher risk weights are assigned for higher balance sheet concentrations.

As discussed previously in this letter, IRR and related risks do not cause credit unions to fail, and well-managed credit unions diligently use sophisticated modeling techniques to model balance sheets under several stressed IRR scenarios. Consequently, we respectfully suggest that residential mortgage loan risk weights for credit union RBC rules be identical to those of banks, which do not include IRR considerations.

Regardless, any RBC regime that includes IRR factors should exclude mortgage loans that reprice or mature within 5 years. By including these loans when determining concentrations and applying risk weights, the proposed rule ignores low IRR posed by these assets. We respectfully suggest that loans which reprice or mature within 5 years be assigned a risk weight separate and apart from risk weight schemes that attempt to consider IRR.

Other residential real estate loans, including home equity loans, are assigned a higher risk weight than first mortgages. This one-size-fits-all approach fails to consider sound home equity underwriting employed by many lenders that appropriately limit the total loan-to-value ratio (LTV) by considering the value of the property as collateral on both any existing first mortgage balance plus the home equity loan. In these cases, credit risk exposure is not different from that of a first mortgage, even if the home equity lender is not the first mortgage lender. We respectfully suggest revisions that appropriately recognize sound home equity lending practices described above, more specifically to treat the resulting home equity loan with the same risk weights as first mortgage loans in situations where a prudent total LTV is considered at underwriting.

Delinquent Consumer Loan Risk Weights – While the proposed rule risk weights delinquent consumer loans in the same fashion as the FDIC, it is important to remember that optimal delinquency and loan losses are very rarely zero for any lender. A certain level of delinquency and related loan losses is normal, expected, and desirable. "Optimal" recognizes an appropriate level of risk by which service to members and earnings are maximized after netting loan losses.

We believe that treatment of delinquent balances in the proposed rule should recognize and allow for desirable "optimal" delinquency. It is difficult to formulate a one-size-fits-all delinquency ratio that is supportable as optimal for all credit unions; however, we believe a ratio of 1.5% is reasonable. We respectfully suggest revisions to the proposed rule that retains the .75 risk weight on delinquent consumer loans up to 1.5% of total consumer loans. Delinquent consumer loans exceeding 1.5% of total consumer loans would carry a 1.5 risk weight.

Credit Union Service Organization Risk Weight – The proposed rule assigns a risk weight of 2.5 to CUSO investments, by far the highest risk weight for assets commonly held by credit unions.

CUSO's are an extremely important part of credit unions' ability to compete for member business, formalizing credit union partnerships with one another that facilitate products, services, and delivery channels that serve members exceedingly well. Additionally, CUSO's allow credit unions to share the cost of development, management, and maintenance of a host of operational functions that would otherwise be cost prohibitive; but are made feasible by the economies of scale that credit union investors are able to gain together.

With the new CUSO rule, NCUA has all the access and authority over CUSO's the agency could possibly need in order to examine, assess, and implement corrective actions to address CUSO-related risks. Consequently, we believe the proposed rule is inappropriate and unnecessary regarding CUSO's, and we respectfully suggest revisions to the proposed rule that assigns a risk weight of 1 on all CUSO investments.

Individual Minimum Capital Requirements

The proposed rule gives NCUA the authority to require higher minimum risk-based capital in credit unions where the agency deems higher capital necessary. We question the need for this provision, given the fact that PCA categories and regulatory actions are already in place, giving NCUA all necessary authority to identify, address, and otherwise work with any individual credit union to restore capital to healthy levels.

We believe the rule, including the revisions requested in this letter, is more than sufficient to facilitate timely NCUA supervisory actions to either restore a credit union to health, or to conclude operation of the credit union at the least possible cost to the NCUSIF. Of course, examination and supervision efforts must be pointed to prompt identification of safety and soundness issues, including requisite cooperation with state supervisory authorities.

Implementation Date

The implementation timeline imposed by the proposed rule, effective 18 months after passage, is simply too short. If enacted as proposed without the revisions suggested in this letter and other communications to the NCUA regarding this matter, an 18-month effective date would have an unintended detrimental effect on otherwise well-managed credit unions.

This complex, far-reaching, and unnecessarily burdensome rule will require management to reassess business models, planned new products and services, balance sheet and operating structures, and projected PCA positions under various balance sheet scenarios. Subsequently, revisions to business and strategic plans will necessarily follow, as will any and all other measures required to execute revised plans.

Consequently, we respectfully suggest an implementation period of at least 36 months.

Conclusion

We agree that an improved risk-based capital regime is necessary for the safety and soundness of the credit union movement, as well as to assure the strength and stability of the NCUSIF; however, we do not support the proposed rule for the reasons discussed in this letter.

Under the proposed rule, business models, balance sheet composition, and risk profiles that survived the greatest economic crisis since the Great Depression will eventually be pared down to accommodate desired capitalization categories. In many cases, the capital cushion desired by credit union Boards and management will be diminished, thus causing modification of otherwise sound business models and practices exhibiting outstanding performance over many, many years of operation.

Compared to banks, significant competitive disadvantages would be imposed by the proposed rule, negatively impacting mortgage lending, small business lending, and overall delivery of products and services to members.

The proposed rule, while well-intentioned, attempts to impose a one-size-fits-all scheme that ignores and thus, discounts the importance of thoughtful, robust, and sometimes assertive examination and supervision efforts, as well as the absolutely essential role of sound and prudent credit union management.

Security Service Federal Credit Union supports NCUA's efforts to improve the risk-based capital regime for credit unions, and stands ready to work with the NCUA to assure the safety and soundness of the credit union system through reasonable and thoughtful regulations that assure the continued value of the credit union charter. If you have any questions or would like to discuss any aspect of the proposed rule, please contact Executive Vice President, Chief Risk Officer Howard Baker; or me at your convenience.

Sincerely,

JIM LAFFOON
President & CEO

cc: Dan Berger, President & CEO
National Association of Federal Credit Unions

Bill Hampel, Interim President & CEO
Credit Union National Association