TRUE NORTH
FEDERAL CREDIT UNION

May 27, 2014

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

Re: Comment on the Proposed Prompt Correct Action – Risk Based Capital Regulation

Dear Mr. Poliquin,

True North Federal Credit Union is $125 Million in Assets, serves 11,000 members, and is open to most of Alaska. We are one of the 189 Credit Unions who will drop from Well Capitalized to Adequately capitalized as a result of the Risk Based Capital proposal put forth by the NCUA. While I agree with the concept of a Risk Based system, I question whether a BASEL type system can successfully be introduced into our current Capital structure, and I profoundly disagree with many of the decisions made by the NCUA in drafting this particular proposal.

NCUA should remove the Well Capitalized Tier from its proposal.

First and foremost, I do not believe the NCUA has the authority to establish a Well Capitalized tier for Risk Based capital. The FCUA states that the Risk Based Net Worth requirement shall "take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection." This language limits the application of the Risk Based standard to the definition of Adequate capitalization, and therefore the 10.5% Well capitalized standard should be removed.

Treatment of Interest Rate Risk:

The current proposal attempts to address interest rate risk while focusing only on the asset side of the balance sheet. The FFIEC notes in its 2010 Advisory on Interest Rate Risk (10-CU-06) that "the most common way to control IRR is through the balance sheet mix of assets and liabilities. This involves achieving an appropriate distribution of asset maturities or re-pricing structures, with the maturity or re-pricing mix of liabilities that will avoid the potential for severe maturity or duration mismatches between assets and liabilities." As Credit Unions are expected to manage interest rate risk through Asset and Liability Management, how can our capital requirements be determined based on only one side of the balance sheet?

Further, the NCUA recognized the flaws in trying to address Interest Rate Risk through capital standards in its 2007 PCA reform proposal. In that proposal, the NCUA states "As the BASEL Committee explains, a balance sheet wide assessment of interest rate risk is costly to incorporate into a regulatory capital scheme and fraught with error as the assumptions related to non-maturity deposits are of necessity

Administrative Office
P.O. Box 34157, Juneau, AK 99803
907-523-4778
Fax 907-586-8078

www.truenorthfcu.org

"blunt and judgmental." Until such time as advancements are made to capital standards to better incorporate interest rate risk, the best approach for NCUA is to address this as part of reclassification authority and the examination program". Which, I might add, you have done with increasingly stringent requirements for ALM programs and Interest Rate Risk management.

Finally, the BASEL standards, including BASEL III for small banks, do not incorporate an interest rate risk element into their Risk Based Net Worth ratings the way the NCUA's current proposal has. While IRR is a material risk facing our industry, the NCUA has given itself numerous tools and the power to leverage them.

Method for determining weights and integration of concentration risk

The NCUA's proposal attempts to address all material risks facing our industry in one calculation. This approach is fraught with logical flaws, but also poses a serious threat to the long term viability of the Credit Union movement.

First, there appears to be little correlation between the weights imposed on loan programs, particularly mortgage and MBLs, and their loss histories, yet the NCUA says they want to ensure that Credit Unions maintain capital levels that are commensurate with their risk. The Credit Union industry has a long history of mortgage and MBL loan losses that equal or outperform that of the banking industry, but the NCUA has used the banking model's risk rates as a starting point, and then escalated the weights to reflect supposed concentration risk.

Second, these concentration risk measures are arbitrary and have no relation to the credit quality of the loans at issue or the likelihood of loss in the event of a massive economic downturn. You can't look at 2 mortgage portfolios that are the same percent of assets and say they pose the same risk. One pool might be 5 year ARMs with LTVs less than 50%, and the other 30 year fixed rate at 80% LTV – two completely different risk profiles that the NCUA treating as the same in this proposal.

Third, the current proposal applies risk weights to investments with federal guarantees, such as monies at the Federal Reserve and those guaranteed by the NCUA and the FDIC, where the investment is guaranteed by the Federal Government and therefore poses little to no risk. Those investments should be weighted based on the risk they truly present and not treated like every other investment type.

Finally, the NCUA has increased the weights associated with these various assets, but is suggesting net worth requirements in keeping with those of the banking industry. So, they have set the same goal and measure of what constitutes well and adequately capitalized, but they have made it harder to get there with no basis in fact or history. This is compounded by the fact that for Credit Unions, PCA is triggered by the adequately capitalized tier, whereas for banks there is no differentiation until the bank drops below adequate capitalization. So the goal is the same, but it's harder to get there for no discernible reason, and the impact for not getting there is harsher. This will result in a profound competitive disadvantage for the Credit Union movement.

True North was a Credit Union that was primarily concentrated in auto and home equity lending until the mid 2000's. Worried about concentration risk and our vulnerability in times of economic change, we began to diversify our loan portfolio to include low interest rate first mortgage strategies and an MBL program. These strategies increased service to our members at a time when they were truly in need, and helped us rebuild capital lost through the collapse of the Corporate Credit Union system. However, these same strategies will now result in our drop from Well to Adequately capitalized. Moving forward, this proposal limits our path to growth and our ability to respond to the needs of our membership.

Treatment of the NCUSIF deposit

We believe that treatment of the NCUSIF deposit should not be excluded from the calculation of net worth. The notion that inclusion of the NCUSIF deposit in our Net Worth ratio calculation is double counting the deposit has merit only from the perspective of a national collapse of the entire credit union system. Coming out of the Great Recession, natural person Credit Unions did well, and while there were losses to the NCUSIF, the integrity of the system remained intact. In 2007, the Dept of Treasury noted that the alleged double counting of equity could be cured by having a higher capital requirement for Credit Unions than banks. The NCUA replied to that in the 2007 Proposal for capital reform that in fact, .25% would adequately mitigate any overstatement of equity in the system. Currently, our leverage ratio requirement is higher than the banking industry and yet this proposal still penalizes Credit Unions by removing the NCUSIF deposit from equity. The alleged risk that the NCUA is trying to address by removing the NCUSIF deposit from the calculation is already addressed by our inflated leverage ratio. All that the NCUA is truly accomplishing with this measure is to increase the capital requirements on Credit Unions yet further.

Individual Minimum Capital Requirement:

The proposal also grants the NCUA the ability to require Individual Minimum Capital Requirements on Credit Unions. At present, according to the FCUA 1790d(h)(2), only the NCUA Board has the authority to reclassify a Credit Union from one Net Worth category as currently defined by the FCUA, and the Board cannot delegate that authority. Under the proposal, it is not clear that the authority to assess an Individual Capital Requirement would lie only with the NCUA Board. Further, the criteria for which additional capital requirements could be required are very broad and subjective. It seems we would have a right to appeal, but success rates for appeals at the NCUA are extremely low, and are a token right at best. The fact that a right of appeal is technically available to us is not sufficient consolation to the weight of the subjective authority that this gives to examiners.

I have been through 20+ exams with True North, and I don't know how many examiners. The tone and perspective of these examiners has been highly variable, and their opinions are rarely uniform. The level of subjectivity I have seen applied to Allowance for Loan Loss, Enterprise Risk Management, and a myriad of other topics is substantial. The notion that this level of subjectivity and variability could be applied to my Credit Union's capital requirement is profoundly disturbing.

I believe that the NCUA does not the legal authority to implement this new IMCR proposal, nor does the infrastructure currently exist to make this a wise tool. The result will be Credit Unions that are driven to an even high buffer over the well capitalized levels in order to protect against the impact of wayward examiners. Again, this will lead to a lack of competitiveness and reduced return to our members.

Summary:

It seems to me that the NCUA is taking the mandate to address "material risks" too far, and is trying to create one ratio to rule them all. The notion that one ratio can adequately measure interest rate, concentration and credit risk strains belief. Simultaneously, they believe that mathematic formulas can't accurately capture risk, so they have created the IMCR. What the proposal will do is harm the industry, while measure none of the risks appropriately. Our leverage ratio requirement is already high compared to our banking competitors. We have survived the Great Recession intact and with a healthy balance in the NCUSIF. Yet the NCUA has put forth a proposal that adds layer upon layer of increased capital burden.

I ask the NCUA to seriously consider their proposal, and look not only to the Federal Credit Union Act for what they truly have the legal right to do, but also to look broadly at our industry and the impact this regulation will have on it. From our perspective, our industry will be profoundly changed by this Regulation, and not in a positive way.

Sincerely,

Lauren MacVay

Lauren MacVay
President/CEO