Pinal County Federal Credit Union

May 20, 2014

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

Re: Comments of Proposed Prompt Corrective Action-Risk Based Capital Regulation

Dear Mr. Poliquin:

Thank you for the opportunity to respond to the proposed risk-based capital rule. Pinal County Federal Credit Union (PCFCU) serves 19,500 members in rural Arizona. PCFCU is a community based credit union with $111 million in assets and a capital ratio of 7.04%.

Pinal County Federal Credit Union agrees that each financial institution should maintain adequate net worth to support its operation and the level of risk to its growth strategies. Pinal County Federal Credit Union is generally supportive of the regulatory efforts to measure and require adequate capital aligned with the individual credit union's risk profile. However the current Proposal will have negative effects not only on PCFCU and its members, but will also have negative effects on the long term strategies for diversification and growth of the credit union industry.

General Comments

Pinal County Federal Credit Union has three main objections to the proposal. First, one ratio cannot adequately measure the risk profile of individual credit unions with unique membership needs and individual strategies. Second, the risk weights proposed by NCUA are significantly higher than those required in the banking industry for identical assets. Third, the implementation period of 18 months for credit unions to improve their risk based capital position is too short a time and will cause an unhealthy focus on compliance with the capital requirements to the detriment of the credit union's current strategy of balancing long term growth with short term capital requirements.

The objections stated here not only apply to Pinal County Federal Credit Union but to others and to the credit union industry as a whole. Each credit union serves a unique population and focus. A standardized "one ratio" requirement to cover all individual asset liability situations ignores each credit union's individual loan and investment portfolios funded by a unique member share base.

Credit Unions effectively compete with large national banks and local community banks. The proposal arbitrarily burdens credit unions with higher capital requirements for identical assets carried on their balance sheet in comparison to the balance sheet of banks. This difference forces credit unions to focus on investments and products based on capital requirements rather than what is best for the membership served and the risks associated with this membership.

The current 18 month implementation time frame for credit unions to comply with the new Risk Based Capital requirement does not allow for a well thought out transition. Once the proposal is finalized, credit unions need adequate time to adjust some of the asset categories to create a balance sheet that aligns earnings and risks. Management of PCFCU believes that one budget cycle is not adequate time to make sound decisions.

Applying a Risk Based Capital methodology has value by taking into consideration the different asset classes containing different loss experience. Although Pinal County Federal Credit Union supports the concept of risk weighting assets, management believes there are modifications that can provide for a credit union's individual profile and maintain credit union value in a competitive market. An adequate phase in period will provide opportunity for capital planning without disrupting strategies for long term growth and member service.

Risk Measure Comments

The investments in an individual credit union should serve to balance risks in other areas of the balance sheet while providing some additional earnings on excess liquidity. The risks of a credit union's balance sheet are unique to its diversification of loans, individual membership behaviors, and local competition.

Pinal County Federal Credit Union has a very conservative investment portfolio based on short term re-pricing and short term cash flows in both an "up" and "down" rate environment. Although the overall investment portfolio is 3.10 year weighted average life in the base case and extends to 3.61 weighted average life in an up 300 basis point environment, according the risk based capital proposal, under the proposed regulation 7 basis points of additional capital is required because some individual securities have a weighted average life of over 5 years.

A recommendation would be to use the BASEL III standards of risk weighting based on the attributes of the security rather than the average life. This captures the nature of the risks inherent in different securities, or lack of risk thereof, and allows credit unions the continued flexibility of using the portfolio to offset other balance sheet risks.

PCFCU is a partner in a CUSO that allows us to provide financial planning and financial management to a small segment of our membership that can benefit from these services while feeling secure about the advisor because the credit union is their trusted partner. PCFCU has no significant influence or control over the CUSO, our investment is appropriately accounted for, under generally accepted accounting principles, using the cost method. Therefore, the risk to capital is limited by the credit union's investment in the CUSO. The proposed risk based capital percentage of 250% arbitrarily penalizes our investment in a CUSO without regard to the actual risk in real dollars that this investment poses. Credit Union Service Organizations allow small and medium sized credit unions, such as PCFCU, the ability to serve members through a cooperative program that could not be managed individually.

Since investment in a CUSO is limited under Section 712 Of NCUA Regulations the arbitrary risk weight of 250% seems to be unnecessary. A risk weight of no more than 100% would adequately allow for the risk to capital of a credit union's ownership in a CUSO.

Diversification of the loan portfolio also provides strength to the Pinal County Federal Credit Union's Balance Sheet during economic cycles. The loan portfolio is not dependent on just one line of business such as indirect auto loans or unsecured consumer loans. PCFCU has a mix of long term fixed rate mortgages, some medium term fixed home equities, and some adjustable rate home equity lines of credit. Along with this we have a portfolio of member business loans which further mitigates concentration risk.

Under the proposed rule, no distinction is made on the risk weightings assigned to loans secured by real property even with various maturities and re-pricing terms. A 30 year fixed mortgage is risk weighted the same as a one year adjustable rate mortgage or a shorter term home equity.

Consumer loans, even unsecured loans, are rated less risky than home equity loans that may be more than adequately secured by real property. These consumer loans are rated less risky than member business loans with significant collateral coverage. Risk weighting that more closely aligns with the Basel III is recommended to capture the spirit of the proposal in weighting loans commensurate with the risk to capital.

With $111 million in assets Pinal County Federal Credit Union is challenged with steady member and share growth each year and with balancing this growth while maintaining our well capitalized status of just above 7%. Under the risk based capital proposal, PCFCU is immediately downgraded to "adequately capitalized." Increasing capital only through earnings constantly challenges management at PCFCU to employ strategies to maintain or reduce our share balances without jeopardizing the long term future of our credit union. An 18 month implementation period, just one budget cycle, would significantly hinder our steady efforts to balance the long term advantages of growth with the short term capital requirements. PCFCU would be forced to make decisions based solely on the urgency to meet the new capital requirements within the deadline set.

The vast majority of credit unions are currently in compliance with the risk based capital requirements as they are proposed. However, credit unions with challenges to their capital should be given ample time to bring their capital into compliance. A phase in similar to the implementation period allowed under Basel III is more appropriate for credit unions that are working to improve their position.

The ability to acquire supplemental capital would also greatly improve the long term outlook for both Pinal County Federal Credit Union and other credit unions growing quickly in membership and assets, with great potential growth in income to follow. This would allow an orderly transition to the new capital standards without hindering the long term outlook for PCFCU and other credit unions in a similar situation.

Conclusion

Adequate net worth and appropriate guidelines with which to measure this adequacy are needed as credit unions gain sophistication and complexity in the financial services industry. These guidelines and measures should not restrict the unique situation of each credit union by trying to mitigate too many risk factors with one ratio.

Aligning risk based capital requirements with Basel III standards would more accurately reflect the risk of credit union's as a financial institution rather than arbitrarily applying more stringent standards to credit unions that would hinder their competitive advantage and their strategies for future growth in this highly competitive financial industry.

Adequate implementation time would allow proper alignment of future strategies with the new risk based guidelines without requiring that current balanced strategies be abandoned in order to focus on short term compliance with the new standard. Credit unions that currently would not meet the risk based requirement for well capitalized, though few in number, would immediately be downgraded though there is no deterioration in their operation.

On behalf of Pinal County Federal Credit Union, I appreciate this opportunity and would ask that you consider these comments in the final rule.

Sincerely,

Alice J. Wilcox

Alice J. Wilcox, CPA
President, Chief Executive Officer