FIRST CITIZENS'
FEDERAL CREDIT UNION
Think First.

May 6, 2014

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

RE: Comments on NCUA Prompt Corrective Actio~~n~~-Risk-Based Capital Proposed Rule

Dear Mr. Poliquin:

This letter is a comment on the proposed Risk-Based Capital standard issued recently by the National Credit Union Administration (NCUA). First Citizens' Federal Credit Union is a $600 million, federally insured credit union serving the Southeastern and Cape Cod regions of Massachusetts. First Citizen's Federal Credit Union appreciates the opportunity to share our concerns on this proposal with NCUA. The NCUA's proposed rule entitled Prompt Corrective Action–Risk-Based Capital in our view is well motivated but seriously flawed in construction. In the following sections, we will elaborate on our concerns.

We recognize that NCUA's rules and guidelines for minimum capital requirements have not changed since calendar year 2000. We support and commend NCUA for attempting to modernize the credit union industry's capital framework, a prudent and necessary effort in light of the financial stresses our industry has endured over the past five years. However well intentioned, we have serious concerns regarding how the proposed regulation is crafted.

The proposed rule attempts to allocate capital to mitigate exposures to multiple types of financial risks. Interest rate risk, concentration risk, liquidity risk, operational risk, market risk and credit risk are the environments in which we operate and manage. The management of these risks is what generates income, and therefore accumulate the capital that allows us to continue to meet our mission to the communities we serve.

Focus on Credit Risk

From a competitive standpoint we feel the Risk Based Capital (RBC) proposal with its overly broad focus severely limits credit unions relative to banks that are tasked with a risk rating scheme focused largely on credit. Financial institutions balance the full range of risks daily in managing the balance sheet and resulting P&L to achieve a return consistent with the institutions overall risk profile. Included within these measures is due diligence regarding Credit

Credit concerns usually lead to a cascading escalation of other operating issues, reduced liquidity and stress on all aspects of a functioning institution. Credit concerns produce stress effects on all areas of financial institutions from restricting strategies, constricting growth, increasing operating costs and potentially, elevated reputational and operational risks. **Credit risk has to be the main focus, always.**

Interest Rate Risk

We cannot understand nor do we support the RBC proposal to focus on risk weighting certain investments based upon duration of expected performance terms. Interest rate risk is the easiest to manage, however the proposal's weighting guidelines seem to remove management's input in the management of interest rate risk via investment portfolios strategies. The proposal does not credit the liability side of the ledger of managing interest rate risk.

At First Citizens Federal Credit Union, we actively manage interest rate risk via:

1. Daily analysis of liquidity availability demands and sources. We also measure for sources of liquidity stress as situations may arise.
2. Weekly ALCO meetings to review loan pipelines, pricing, deposit activity and pricing, cash flow needs, market conditions and strategies.
3. Quarterly asset / liability simulations with:
    - Various scenarios of rising and falling interest rates and their impact to net interest income
    - Simulations with severe stress scenarios including high rate increases, deposit migration from low cost to higher cost term deposits, etc
    - Simulations of basis risk changes
    - Simulations and analysis of economic value of equity, stressed similarly as above
    - Simulations of various balance sheet restructures to gauge impact on net interest income and capital
4. We also occasionally model special simulations for strategies that may arise related to local, regional or national market events.
5. We occasionally increase or decrease exposure to IRR based upon management's assessment of the best course to follow to manage the institution in a safe and sound manner.

The RBC proposal on interest rate risk, if implemented as currently drafted, may serve to partially remove management's input in the managing of IRR via use of investments. Subconsciously or not, managers will avoid using longer-term investments for the simple purpose of avoiding increased risk weightings and therefore, reduced RBC.

Supervisory examinations must continue to serve as the measurements of how institutions manage credit risk and the ancillary risks such as interest rate risks. To install a capital management rule with the intention to manage interest rate implies a degradation of the field examiners reviews. A "one size fits all" mentality regarding interest rate risk we believe is shortsighted. If adopted, it may constrain growth and ultimately injure the communities we serve.

Remove the interest rate risk proposed language, let your field examiner's continue to review the IRR management functions of the examined. Let management continue to use the various tools available to manage IRR rather than depend on a wholly static, and somewhat arbitrary, standard set by regulators.

Risk weighting of Federal Reserve deposits

The RBC proposal indicates that deposits held at Federal Reserve Banks are to be risk weighted using a 20% factor. We believe the risk for these transactions are similar to US Treasury bonds, the full faith and trust of the US Government. Federal Reserve deposits should be weighted at zero, other non-governmentally backed (implied) should be weighted at 20%. There is no reasonable risk to deposits held at Federal Reserve Banks, they are immediately available funds with no possible loss due to market changes.

Concentration Risk

Similar to interest rate risk, we believe concentration measures of balance sheet composition should best be managed by each financial institution and the specifics that may apply to their operational environment. Field examinations should identify how institutions are addressing concentration risks and what impact asset-specific stresses might have on capital, liquidity, earnings etc. To once again adopt a "one size fits all" approach and penalize institutions whom may successfully adopt higher concentrations of certain assets categories is unfair and unwise.

- Unwise in that management will again abide by regulatory guidelines and seek to avoid regulatory scrutiny. If adopted, RBC's weighting of mortgage loan concentrations may reduce the prudent investing in mortgage loans by credit unions, a product line that local communities need and that credit unions deliver very well.
- We cannot understand how the ratio of current and non-delinquent 1st mortgage loans >35% are risk weighted at 100%. A similar risk weight category as MBL loans if <=15% assets. 1st mortgage loans are underwritten to stringent, mortgage industry standards. How can a mortgage within the higher concentration risk pool have a higher risk component than similar loans under 35%?
- Grappling concentration measures upon risk weightings for selected asset classes magnifies the required capital to no productive end.
- If asset liability simulations indicate asset sensitivity, one of the tools to consider is increasing the portfolio of 1st mortgages. To avoid RBC negative impact, an institution may not prudently consider employing such a tactic and instead invest in other asset

classes. The RBC guidance on risk mitigation due to concentration may not be prudent or beneficial to capital accumulation.

We urge NCUA to amend the concentration guidelines relating to risk weights or better still eliminate them all together. Tying the hands of the industry to a mandated percentage-asset allocation has always proved to be detrimental to the health of financial institutions; and no regulator has ever had a sufficient crystal ball that has adequately predicted the long run stability of any asset class. Again, we highly advise that independent field examiners identify possible concentration risks, which are generally situational and follow perverse cycles, and issue guidance to those situations as warranted. Do not penalize the whole industry for the myopic sins of the few.

CUSO and Mortgage Servicing Rights

We do not understand the guidance for risk weighting CUSOs. Our investment in CUSO, currently an insurance company, the risk is our 100% of investment. Our external auditor regularly reviews our CUSO operations. The 250% risk weight allocated to CUSOs seems punitive and is clearly geared to staunching the use of these very useful investment vehicles. The NCUA's lack of sufficient attention to past CUSO generated excesses is no reason to stop prudent institutions from using them to build earnings, capital and service excellence for their members. Again, based upon examinations and or independent audits, apply increasing capital constraints as needed on individual basis. Do not penalize the general population using a "one size fits all" approach.

In regards to mortgage servicing rights, all institutions recognizing these assets must adhere to generally accepted accounting principles (GAAP) in the accounting and recognition of income for these assets. Regularly, MSRs must be evaluated for impairment to market activity, and applicable write downs taken. If the intention of RBC to weight MSRs at 250 is to provide for a possible inconstancy in applying accounting guidance, then once again we believe the proposal is penalizing the whole for the impropriety of the few. Insist on adherence to GAAP, MSRs should be weighted at the greatest possible risk of loss, 100%, not 250%. Finally, how can the servicing rights have greater risk than holding a mortgage itself?

NCUSIF Deposits

Proposed RBC rules required that NCUSIF deposit(s) be deducted from both risk based assets and capital. This treatment implies that NCUSIF deposits, held as assets, are worthless, i.e. should be expensed. NCUA continues to disclose that these deposits are valid credit union assets, in direct contradiction to the RBC treatment. Amend the proposal; at minimum assume that NCUSIF deposits exhibit the same risk as deposits in a non Federal Reserve Bank, i.e. 20%. Which as we suggested above is not required, these assets are immediately available funds.

Additional Authority for Examiners to Impose Higher Capital Requirements

We value examiner reviews, it remains a critical tool in the determination of solvency. Throughout this document, we have argued for continuing to use examiner observations for various matters attributable to operating a financial institution.

We cannot however support RBC's proposal that grants additional authority to individual examiners to impose higher risk based capital requirements. Examiners should focus on what they do well, observe, review, document and recommend on credit union management; to manage, not to eliminate risk. To empower examiners to set capital requirements is not a wise precedent. If adopted, the guidance may compromise management's ability to execute.

Capital Requirements

The determination of the minimum RBC capital for well capitalized should be consistent with banks. The minimum well-capitalized limit of 10.50% is too high; consider reducing it to 10%.

Implementation timeline

We believe the transition period of any RBC proposal, (amended to reflect the suggested changes contained herein), should be extended well beyond the currently proposed timeline. Banks have until 2019 to abide by the proposed Basel III rules. We believe a longer period than is currently contemplated is prudent. Consider that institutions will begin restructuring balance sheets and changing strategies, some of which are tied to two, three and five-year strategic plans. To insist on a quick implementation may threaten an already weak economy and those institutions that have begun to finally expand operations following the financial calamity of the past 5 years.

Thank you for the opportunity to comment on the proposed RBC rule. We understand the importance NCUA is putting on managing credit union risks to prevent a recurrence of the "great recession" and its impact on financial institutions. Recall however, that the collapse of the financial services industry was in no way caused by natural-person, credit unions. It was caused by the tsunami created by Wall Street excesses, resulting regional collapses and the failure of the Credit Union Corporates. Basel II did not work to prevent these problems, Basel III will not serve to prevent these problems and neither will the current RBC proposal by the NCUA.

Good management, good governance and insightful and cooperative supervision will ensure that institutions manage risks effectively and preserve their institution for the members of today and tomorrow.

Please call feel free to contact us directly with any questions or additional information you may require.

Sincerely

George M. Custodio
Senior Vice President, Chief Financial Officer