MEMBERS 1st
FEDERAL CREDIT UNION

May 28, 2014

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

RE: Comments on Proposed Rule: PCA - Risk-Based Capital

Dear Mr. Poliquin:

Members 1st FCU believes the idea of a risk-based capital calculation is worth considering, however, not in addition to the capital requirements contained in PCA, but rather as an alternative to PCA - this would require legislation. Some Credit Unions do not need 7% net worth based on their balance sheets. We also strongly believe that the risk based weighting levels should have some correlation to the losses experienced in the various asset categories which are reflected in the Bank's RBNW rule, and not an arbitrary level. For example, Other Real Estate Secured Loans have the same risk weighting as delinquent Real Estate Loans, with no consideration for LTV, maturity, etc. Our Real Estate Secured loans have one of the lowest loss ratios of any loan type, yet the proposed risk weighting does not reflect that level of risk. Only 112 credit unions failed during the Great Recession costing the insurance fund less than $1 billion, which is remarkable considering the dollars and number of commercial banks that failed and they had a comprehensive RBC plan in place, it lulled them into a false sense of security. The issue wasn't low capital positions, the issue was sound (or lack of) underwriting practices, that is the better way to promote safety and soundness. The credit union industry came through the worst economic conditions since the 1930's in fairly good shape. Prior to the Great Recession, during the period 2003-2007 the average annual loss to the NCUSIF due to liquidations or assisted mergers was $18.4M. Therefore, we question the need for additional net worth requirements over and above PCA. Also, the NCUA mentions creating a risk based capital framework that is more "consistent" with other Federal Banking agencies, this proposal does not accomplish that.

In general, we believe that the NCUA Board is trying to create a one size fits all type of calculation by including credit, concentration, liquidity and interest rate (maturity) risk into the calculation on an inconsistent basis to maximize the final capital requirement. This proposed rule appears to be nothing more than a veiled attempt to increase net worth requirements across the entire credit union industry. While initially only 190 credit unions will see their current net worth category decrease, all credit unions will struggle in the future as they attempt to grow and still maintain a "well capitalized" position. This will stifle credit union growth, reduce our competitive position vis a vis the banks, and also result in fewer MBLs and real estate secured loans which in turn will adversely impact the already slow economic recovery we have seen over the past few years and associated high unemployment levels as well.

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Interest rate (maturity), concentration and liquidity risks are already addressed in a CU's Interest Rate Risk modeling, and A/L Management and Concentration risk policies as required by NCUA regulation. If there are issues with a CU's program in any of these areas, the field examiners have the ability to question and require changes after expressing their concerns at the time of examination. Capital requirements should not be a substitute for proper credit union management nor appropriate examinations.

Our primary concern with regard to introducing interest rate (maturity) risk into the proposal is that NCUA is penalizing CU's for booking longer term securities presumably because they are concerned about rising interest rates; this is somewhat short-sighted. Our issue is that when rates do return to a more "normal" level, and they will, the financial industry will have to protect themselves against rates rising and falling. As we know in a falling rate scenario having good credit, longer term fixed rate investment securities on their books will help CU's, however, their risk-based capital profile would penalize their position. We recommend that the Board revise their tiered investment portfolio system to reflect more credit based risk positions of 0% for direct guarantees of the US Government; 20% for GSE's and 100% for other investment types. Many CU's with lower loan to share ratios rely on longer term investment securities for income, if purchased within a well-managed asset/liability program these longer term, good credit securities do not pose any more of a threat to the NCUSIF than shorter term securities. Effective Interest Rate Risk modeling of the entire balance sheet is a better indicator of "proper" and "reasonable" balance sheet management than placing onerous and unnecessary capital requirements on the industry.

We are also very concerned about the 250% rate for CUSO investments, FHLB stock and mortgage servicing rights. First, CUSO activities are regulated by the NCUA and have increased reporting requirements if they are complex, also investments in plus loans to them are already restricted to 2% of assets. CUSO's have been used effectively for years by credit unions to reduce costs and provide products and services to their members that may have been cost prohibitive without the CUSO. The 250% capital requirement would discourage investment in these valuable entities. If a credit union has investments and loans in CUSO's totaling $1M, the maximum they can lose is $1M – why require $2.5M in net worth to cover a potential $1M loss? Second, mortgage servicing rights are no more risky than the assets they are tied to and the only variance is the length of time to amortize the asset - that does not warrant a 250% level. Third, the US Government has oversight of the FHLB system and there is no reason their stock should require such a high level of capital. We recommend that the Board revise the risk-based calculation to no more than 100% for all of these assets.

Member Business Loans (MBL) are tiered at 100% for the first 15% of assets, 150% for 15 – 25% and 200% for assets in excess of 25% and without distinction for types of collateral. We find it contradictory that the NCUA Board advocates to Congress for an increase from the current cap of 12.25% to 27% to allow CU's to have a more competitive position versus banks and then sets unusually high RBC % on balances over 15% and 25%. When you consider that the vast majority of our MBL's are collateralized by real estate, not receivables or other less marketable and risky assets of the member companies and you compare the levels to the residential real estate levels of 50%, 75% and 100% you see a major exaggeration in the requirement. The RBC net worth requirements have no relationship whatsoever to the loss ratio's that we have experienced even during the recent Great Recession. We recommend that MBL's secured by real estate be risk weighted at no more than 75% up to 35% of assets and 100% in excess of 35% of assets. Other non-real estate MBL's should be weighted at 100% up to 15% of assets and 150% over 15 % of assets.

Non delinquent 1st mortgage real estate loans are also proposed to be tiered by concentration %. We believe this risk is addressed by concentration risk regulations and should not be tiered at 50%, 75% and 100% depending on a % of assets. The Board actually seems to be encouraging CU's to book loans with less or no collateral (auto, RV and mobile home loans which can be crashed, stolen or driven away; credit card loans; student loans; unsecured loans) to prevent concentration risk in real estate collateralized loans. The primary reason for the economic and real estate crash in 2008 was because of faulty underwriting standards (sub-prime credit) and providing loans to individuals that couldn't afford them, not because they were collateralized by real estate per se. Furthermore, the significant losses in real estate loans were centered in the four "sand states", not in the other 46 states. Our loss ratio for real estate secured loans is among the lowest of all of our loan products – again, the RBC net worth requirements have no relationship to the loss ratio's that we have experienced even during the recent Great Recession. While we believe concentration risk should not be factored into the calculation, we recognize that without a major addition of credit related information to the Call Report it does provide some level of risk control. We recommend that non delinquent 1st mortgage real estate loans have a risk weighting of 50% up to 35% of assets, 75% in excess of 35% of assets, and 100% in excess of 50% of assets.

We also recommend separating Other Real Estate loans from Delinquent Real Estate loans because they are primarily 2nd lien Home Equity loans. We recommend the Other Real Estate loans be treated the same as MBL's collateralized by real estate at 75% up to 35% of assets and 125% over 35% of assets.

Consideration should also be given to increasing the 1.25% allowance limit for adding to the numerator. In the event of passage of FASB's proposed Current Expected Credit Loss model, it is most likely to increase normal reserves by an estimated 30% to 100% at some credit unions. We believe there should be no cap on the allowance counting towards capital, particularly in view of the possibility of higher credit allowance standards being adopted in the future.

The NCUSIF deposit should not reduce the risk based capital numerator nor should it be credited in the denominator. We recommend it not be a factor in the risk based calculation at all.

The proposal would give the NCUA examination teams the ability to increase a CU's risk based capital requirement on a case by case basis. We strongly oppose this provision and believe that the FCU Act does not provide express authority for NCUA to be able to do this. Examiners and Regional Offices have other remedies if they believe a CU is being run at a risky level. CU's do not have a way to add to capital other than through earnings, allowing NCUA to arbitrarily increase their risk based requirement could jeopardize the very existence of the CU or require an unfounded sale of assets just to produce current income sufficient to boost the capital levels. This provides too much authority to change the "playing field", especially when there is no independent entity to which a CU can appeal an NCUA decision. The current appeal process, if taken that far by a CU allows that an independent arbitrator's decision isn't binding and the NCUA Board may choose to ignore it.

The Proposal has an 18-month implementation time frame for credit unions to comply with the new Risk Based Capital requirement. This does not allow for adequate transition and is well short of the BASEL III five-year implementation period for banks with the additional 2.5% capital conversion buffer not fully phased in until 12/31/2018. Once the Proposal is finalized and implemented, credit unions will need time to adjust some of the asset categories to create well rounded balance sheets that align earnings and risks based on the final RBC rule. We believe an 18-month implementation period doesn't give credit union management and board members ample time to make sounds decisions. As a result, we believe that NCUA should allow credit unions the same amount of time to fully implement the Risk Based Capital as our counterparts in the banking industry.

We believe there could be merit to a risk based capital calculation provided the capital level requirements are reasonable and defendable and primarily based on credit considerations not a combination of credit, maturity and concentration risk. It has been estimated by the national CU associations that this approach by the NCUA Board would require CU's to set aside or accumulate an additional $6.3 – 7.3 billion in net worth to remain well-capitalized. This would severely undermine the industry's ability to grow, compete and provide the products and services their members both need and desire. When you consider that the total losses to the NCUSIF over the last 5 years since the economic collapse in 2008 were comparatively small at less than $1 billion, it appears that this regulation is overblown and unwarranted as it currently exists. Again, while only about 190 credit unions would initially see their capitalization category reduced with this proposed regulation, all credit unions would struggle to meet the RBNW requirement for well capitalized as they grow in the future. This would reduce credit union growth, and make us less competitive to other financial institutions that do not have similar risk based net worth requirements.

Sincerely,

Robert L. Marquette
President/CEO
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