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MAY 28 '14 AM11:12 BOARD

May 22, 2014

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

Dear Mr. Poliquin:

Thank you for the opportunity to comment on the Proposed Rule: PCA-Risk-Based Capital (Proposed Rule). We have reviewed the language and appreciate the NCUA's efforts to strengthen risk monitoring practices. While we believe that the Proposed Rule provides a useful roadmap as a management tool, the proposal would better serve as guidance to the industry rather than a requirement on prompt corrective action regarding risk-based capital. In particular, the Proposed Rule provides, at best, a surface level alignment to the stated purpose for the Rule, which is to mitigate risk across multiple areas. As set forth below, we believe there are better tools to assess and mitigate risk in all risk areas than those outlined in the Proposed Rule. In the event that NCUA chooses to implement the Proposed Rule as a PCA standard versus guidance, we believe such a standard requires improvement by (1) adjusting certain risk weightings, (2) eliminating inconsistent implementation, (3) including liabilities, not just assets, in the risk weighting equation, and (4) allowing more time for implementation.

Appropriateness of PCA Requirement

In order to address the Proposed Rule in the context in which it was designed, we first highlight the purposes outlined by the NCUA for the Rule's proposal:

"In developing the new risk-based capital requirement for 'complex' credit unions, NCUA sets forth the following goals for the proposed rule. First, the requirement should address weaknesses in the net worth ratio measure. Second, the requirement should address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk. Third, the requirement should enhance the stability of the credit union system. Fourth, the rule should rely primarily on data already collected on the Call Report to minimize additional recordkeeping burdens. Fifth, the requirement should be, given the preceding four goals, as easy as possible to understand and implement." (12 CFR 700).

A review of the specific risks outlined below demonstrates how the NCUA's goals would not be fulfilled by the current language in the Proposed Rule, particularly with regard to addressing weaknesses in net worth, enhancing the stability of the credit union system, and creating a requirement that is easy to understand and implement.

Interest Rate Risk

We believe the use of asset liability models are far superior in their ability to assess varying forms of interest rate risk associated with each individual credit union. The inclusion of metrics including NII volatility and NEV volatility provide for a dynamic view of an institution's interest rate risk position and, in our opinion, best reflect these risks. The incorporation of the liability structure of the balance sheet, as well as the ability to

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identify potential impacts to capital and income, make for a robust and substantive measurement of interest rate risk. We encourage the NCUA to continue to focus on this practice as the primary means of assessment of interest rate risk and regulatory oversight associated with it.

Current proposals in the Proposed Rule focus heavily on interest rate risk, particularly risk weightings for investment securities. (12 CFR 702.104(c)(2)). In our opinion, the weightings associated with this proposal rely heavily on asset duration and do not address risks associated with asset sensitivity. An institution with elevated operational expenses and short duration assets would experience significant margin compression in extreme low rate environments and may be misled by proposed risk based capital weightings in assuming risk will be mitigated by keeping portfolios weighted to the front end of the yield curve. This can create inconsistency with risk measurements provided by a more robust analytical tool. The same inconsistency can occur when analyzing securities with embedded options and negative convexity. Base case projections on many of these securities will fall into short risk weighted buckets, but the realization of extension or cap risk creates a higher risk profile that would be better identified through a more complex modeling process.

Credit Risk

We believe that measurements of regulatory capital can be effective in identifying the presence, and to some degree, the magnitude of credit risk. That being said, while we do not necessarily disagree with the risk weighting on many asset classes, we nevertheless believe it is impossible to accurately reflect the credit quality of an asset at the account level and believe it is essential to include loan level detail in any thorough credit risk analysis. In our opinion, this would be extremely difficult to implement in a risk based capital rule given the operating capacity of many credit unions. The analysis associated with a loan level credit detail, and corresponding risk weighting, would likely prove burdensome for many to understand and implement, in contrast to the NCUA's stated goals. For this reason, we view the current risk weighting associated with credit as useful for informational purposes but inadequate as a controlling measurement of credit risk on an institution's balance sheet, and therefore inappropriate as a tool for enforcement actions.

Concentration Risk

Assessment of balance sheet concentration is an important and meaningful component of risk management for both assets and liabilities. We believe this risk cannot be clearly defined by the simple presence of concentration in an asset class. The nature of the risk of a concentrated asset is relative to the impacts the asset would sustain in an environment where specific credit, rate, or liquidity risk was realized. This creates a measurement that would be more appropriately encompassed through ALM modeling and stress testing. When properly implemented, these analyses will identify risks in an asset class. The lack of sophistication in assigning risk weightings purely based on concentration may unfairly penalize an institution for concentrations associated with service to membership.

Liquidity Risk

In our opinion, this risk is far more complex than what can be assessed through asset weightings. While certain institutions may appear illiquid or have a high concentration of assets associated with liquidity weightings, the availability of secondary sources and contingent sources of liquidity are given no credit. The liquidity of an asset may be assessable based on market metrics but the liquidity of a balance sheet or financial institution involves significant levels of external support and funding availability. In addition, liquidity risk is driven by both internal and external factors. Therefore, a simple risk-weighting approach, which is primarily driven by an internal balance sheet, cannot fully reflect the externality or risks introduced by other financial institutions facing liquidity challenges. We have seen its impact during the recent financial crisis, where many financial institutions were severely impacted by third party liquidity providers facing liquidity challenges. We

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fully support recent NCUA action regarding contingent liquidity sources and believe the focus in this area should remain on broader balance sheet implications. We encourage the NCUA to continue to explore more complex forms of liquidity measurement and monitoring.

Market and Operational Risk

In our opinion market risk is reflective of the realization of other risks associated with the assets and liabilities on an institution's balance sheet. We do not believe the complex structure of market risk can be meaningfully represented by risk weighting. While we agree the impacts of markets on asset values need to be consistently assessed, we do not see any material benefit to applying a risk weighting associated with market movement. With regard to operational risk, we believe the majority of these risks are present in the day-to-day functions of the institution and span a range of risks including fraud, cybercrime, and natural disasters. The nature and avoidance of these risks are institution-specific and involve a series of risk mitigation strategies that are implemented on an operating basis. We firmly believe that risk weighting of assets is an inappropriate way to measure this form of risk and believe the best measurement involves front line communication between staff and auditors.

In the event NCUA chooses to implement the Proposed Rule as a PCA standard, we further believe that additional changes, set forth below, are necessary.

Adjusting Certain Risk Weightings

The proposed risk weightings for certain asset classes diverge from international standards laid out in the recently agreed upon Basel III Accord. In order to maintain consistency with broader industry standards, and provide for ease of implementation should future accords develop alternative weightings for asset classes, we would recommend the alignment of the proposed rules risk weightings with Basel III standards. Alliant Credit Union is of the opinion that this will place the NCUA in the best position to benefit from broad industry research and its application to current and future Basel Committee regulatory standards. In addition, alignment with Basel III risk weightings would ensure that credit unions are on an even playing field with banks in the marketplace. For example, the proposed concentration categories for member business loans are much higher than the current requirements and higher than those for small banks. There is currently no evidence to suggest credit union business loans carry higher degrees of risk than those made by community banks. High risk weightings may have the effect of reducing or terminating the origination of credit union business loans, which may in turn negatively impact members by placing credit unions as a competitive disadvantage.

Eliminating Inconsistent Implementation

The Proposed Rule allows for inconsistency in implementation. It requires some credit unions to maintain higher capital amounts, and examiners would have the ability to impose higher capital requirements unilaterally without review by the NCUA Regional Director and NCUA Board. (12 CFR 702). We believe that the rule should be uniform for all credit unions. The NCUA has stated that proposed requirements should be as easy as possible to understand and implement. However, the subjective discretion examiners would have regarding capital amounts would actually make implementation and understanding of the new capital requirements more difficult. It is essential that credit unions understand what their capital requirements are. That determination should not be made on a case-by-case basis by examiners, who may vary in their own individual opinions as to what capital should be for each credit union.

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Including Liabilities in Risk Weightings

While the Proposed Rule sets forth higher risk weights on long-term assets, it does not take into account liability duration. As a result, the Proposed Rule has the effect of penalizing a credit union on the asset side of the balance sheet without regard to liabilities as a source of funds to match its assets. Any final rule should set forth how liabilities should be treated in the risk weighting equation.

Allowing More Time for Implementation

The proposed implementation timeframe of 18 months will not allow enough time for many credit unions to phase in any necessary operational changes to comply with the rule requirements. Additionally, certain credit unions may require balance sheet reorganization and a significant change in their entire business model. In the event the NCUA chooses to proceed with the Proposed Rule and make it final, we believe that three or more years for the implementation period would be necessary.

In conclusion, thank you again for the opportunity to comment on the Proposed Rule. We hope that our feedback is helpful, and that the NCUA will consider our proposal to convert the Proposed Rule to issued guidance to the industry.

Sincerely,

David W. Mooney
President and CEO

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