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March 20, 2014

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

Delivered Via Fax 703-518-6319

Subject: Comments on Prompt and Corrective Action- Risk Based Capital Proposed Rule

Dear Mr. Poliquin:

Please share this letter with the NCUA Board as they evaluate public input on the subject matter. As a general rule, I am in favor of less capital for low-risk credit unions and more capital for higher-risk credit unions. If changes are made to risk weights, we are provided access to secondary capital and the ability of examiners to subjectively increase risk-based capital is removed, you may have a workable regulation.

As requested in the Federal Register, my comments will follow the headings of the proposed rule. After I have addressed certain headings, I will conclude with a summation of my opinion.

Subpart A- Prompt Corrective Action

702.102 Capital classifications

I don't think the Federal Credit Union Act gives the NCUA the authority to create an additional standard for a credit union to be well capitalized. The law gives the NCUA the authority to develop a risk-based capital requirement in order to maintain adequacy of capital, period. Furthermore, a case could be made that if a credit union is retaining capital over 10% it could be deemed that they are not operating in the best interests of their members. The money does belong to the members and should be treated as such. Excessive retention of capital does not provide a member benefit. It means we are charging higher rates for loans, paying less on deposits and charging higher fees than necessary.

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701.104 Risk-based capital ratio measures

(b)(1) Capital elements of the risk-based capital ratio numerator
(vi) ALLL should not be limited in any fashion. If a credit union's loss experience, coupled with anticipated losses exceeds 1.25%, then it should be included.

(vii) Having the authority to raise secondary capital for low-income credit unions (LICUs) is a great tool, if the NCUA would have provided clarification on the efficient means by which LICUs can obtain such capital. At present, most LICUs have no idea how to raise such capital. NCUA guidelines are necessary.

(2) Risk-based capital numerator deductions
(i) The NCUSIF capitalization deposit should be included, not deducted.

(ii) Goodwill should be included, not deducted. A few years ago we merged a smaller Credit Union into our operation. The prior CEO had been self-dealing and the operation was in trouble. Rather than have the news of his malfeasance spread across the front page of our small town local paper, we agreed to merge them, without any government assistance (again to avoid bad public relations and indirectly suffer reputation risk, even though we had nothing to do with their problems). We should have been allowed to book goodwill in this transaction, keeping the NCUSIF intact and not allowing all local credit unions to be painted with the same journalistic sensational reputation damaging paintbrush. Please note below that I have transferred many items from one category to another. If it appears in a category I have identified, then delete it from the category I removed it from

(c) Total risk-weighted assets
(2) Risk-weights for on-balance sheet assets
It appears to me that the following risk-weights are much too high, given the loss history in the credit union industry. The banking industry historically has higher losses than the credit union industry. These need to be de-coupled from BASEL III (the consumer loan weight from 100% to 75% is a good example). The weights should be empirically based, not just some subjective number the Agency felt was appropriate.
(i) Category 1 - zero percent risk-weight
In addition to cash on hand, cash on deposit should be included in this category.
(ii) Category 2- 20 percent risk-weight
This category should also include the following: a) the total amount of investments with a weighted-average life of three years or less. b) the total amount of current and non-delinquent first mortgage real estate loans less than or equal to 30 percent of total assets.

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(c) Total risk-weighted assets, continued

(ii) Category 2- 20 percent risk-weight, continued
c) the total amount of current and non-delinquent unsecured credit card loans, other unsecured loans and lines of credit, short-term, small amount loans (STS), new vehicle loans, used vehicle loans, leases receivable and all other loans, excluding member business loans.

(iii) Category 3- 50 percent risk-weight
This category should also include the following: a) the total amount of investments with a weighted-average life of greater than three years but less than or equal to five years. b) current and non-delinquent first mortgage real estate loans greater than 30 percent of total assets and less than or equal to 40 percent of total assets. c) delinquent first mortgage loans. d) other real estate loans less than or equal to 10 percent of assets. e) member business loans less than or equal to 20 percent of assets. f) the total amount of any foreclosures and repossessed assets. g) land and building, less depreciation on building. h) any other fixed assets, such as furniture and fixtures and leasehold improvements, less related depreciation.

(iv) Category 4- 75 percent risk-weight
This category should also include the following: a) current and non-delinquent first mortgage real estate loans greater than 40 percent of total assets. b) all other assets not specifically assigned a risk-weight but included in the balance sheet. c) the total amount of investments with a weighted-average life of greater than five years but less than or equal to ten years. d) total amount of all other real estate-secured loans greater than 15 percent of assets and less than or equal to 25 percent of assets.

(v) Category 5- 100 percent risk-weight
This category should also include the following: a) the total amount of investments with a weighted-average life of greater than ten years. b) member business loans greater than 20 percent of assets and less than 30 percent of assets. c) the total amount of investments with a weighted-average life of greater than ten years. d) the total of all delinquent consumer loan (unsecured credit card, other unsecured loans and lines of credit, new and used vehicle loans, leases receivable (excluding loans reported as member business loans).

(vi) Category 6- 125 percent risk-weight
This category should only include the following: a) any delinquent member business loan. b) the total amount of member business loans greater than 30 percent of assets, other than the member business loans included in Category 5 above.

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(c) Total risk-weighted assets, continued

(vii) Category 7- 150 percent risk-weight
This category should only include the following: a) the total value of investments in Credit Union Service Organizations.
(viii) Category 8- 200 percent risk-weight
This category should only include the following: a) the total value of mortgage servicing assets.
(ix) Category 9- 250 percent risk-weight
This category should only include the following: a) an asset-backed investment for which the credit union is unable to demonstrate, as required under 702.104(d), a comprehensive understanding of the features of the asset-backed investment that would materially affect its performance.
(x) Category 10- 1,250 percent risk-weight
This category should be deleted.

(3) Risk-weights for off-balance sheet activities
(i) A 75 percent conversion factor with a 100 percent risk-weight for unfunded member business loans.
This category should be a 50 percent conversion factor with a 50 percent weight.
(ii) A 75 percent conversion factor with a 100 percent risk-weight for member business loans transferred with limited recourse.
This category should be a 50 percent conversion factor with a 50 percent weight.
(vii) A 10 percent conversion factor with a 75 percent risk-weight for total unfunded commitments for non-business loans.
This category should be a 10 percent conversion factor with a 20 percent weight.

The proposed risk-weighting formula assigns inappropriate risk weights to many investments. The weights do not weather empirical testing. The inappropriate risk-weights will cause many credit unions to manage for risk-based capital, rather than on the actual risk of the assets and the asset/liability needs of the credit union. This would have an adverse impact on many credit unions that have successfully demonstrated the ability to manage such investment portfolios.

The proposed risk-weighting formula concentration escalators apply higher weights to real estate secured and member business loans than our banking counterparts, even though the credit union industry has demonstrably better loss histories. That is just plain wrong. Base these on our industry's performance. Our losses are 30% of what the banks experience.

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It should be recognized that the BASEL system only assigns credit risk, while this proposal attempts to capture credit, interest rate and concentration risk and other risks. This alone should be cause for reducing the proposed risk-based weights in order to put us on a level playing field.

702.105 Individual minimum capital requirements
(b) Appropriate considerations for establishing individual minimum capital requirements
We wholeheartedly disagree with an examiner having the authority to establish higher risk-based capital requirements, based upon their subjective opinion. If a credit union is operating under a Letter of Understanding and Agreement (LUA) or some other enforcement action, then the Agency should factor that into the risk-weighted categories. Maybe the Agency should factor in an average of the last five year's CAMEL ratings into the risk-weighted categories. This should capture the risk you are trying to address, without giving one person unilateral authority (I am not in favor of this either). Furthermore, the examiner can only increase the risk-based capital requirement, not decrease it. I see this authority subject to abuse. Now I know the Agency tries to hire the very best, but over my 34 year career I have run into a number of examiners that think they know more about running my Credit Union than I do. Frankly, I am not interested in their opinions. I only want them to evaluate my Credit Union based upon our financial performance and compliance. When I run into one of these "opinion complex examiners", we invariably have problems. I don't need them artificially setting my Credit Union up for failure because they don't like me (it happens). Giving an examiner this authority is going to cause huge problems, based upon their subjective opinion of:
(c) Standards for determination of appropriated individual minimum capital requirements.
(3) "management strength, future prospects of the credit union".
(5) "the policies and practices of the credit union's directors, officers and senior management as well as the internal control and internal audit systems for implementation of such adopted policies and practices."

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This proposal needs to bc quantitative, not subjective. Given the current low spread environment, it would be extremely difficult to add large amounts of reserves to our balance sheets in the next few years ($7.3 billion is a big number). The 18 month effective date is not enough time for credit unions to change their balance sheets in any significant way. Loans take time to run off and investments take time to mature. The effective date should be based on the average life of credit union loan and investment portfolios. An effective date of three years (or whatever the empirical number of loan/investment turnover is) gives us some time to modify our loan and investment mix.

Thank you for this opportunity to share our concerns with you on the proposal. We look forward to a final rule that more closely resembles the natural person credit union's performance. We understand the Agency took a beating in the supervision of the corporate credit union's financial implosion. But, the two industries are drastically different and should be treated as such. Again, thank you for your time and consideration.

Very truly yours,

Gary G. Sterton, CEO
Animas Credit Union

cc: Animas Credit Union Board of Directors
Credit Union National Association

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