April 8, 2014

Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314
regcomments@ncua.gov

Re: Comments on “Prompt Corrective Action – Risk Based Capital”

Dear Mr. Poliquin:

TruStone Financial Federal Credit Union appreciates the opportunity to comment on the National Credit Union Administrations proposed rule entitled “Prompt Corrective Action – Risk Based Capital”.

We support the NCUA’s efforts to develop a more comprehensive risk based capital framework to further protect the safety and soundness of credit unions. Specifically, a framework that not only takes into account credit risk, but also seeks to take into consideration concentration risk, interest rate risk, etc. With that said, we believe the proposed rule has room for improvement in several areas. While well intentioned, it is our opinion that this rule will cause the misallocation of credit union capital towards less productive use, ultimately increase the risk borne by credit unions, and put credit unions at a competitive disadvantage to other financial institutions.

Our primary concern is how interest rate risk is inconsistently considered across various asset types in this rule. It is unclear when interest rate risk contributes to a risk weighting and when it does not. For example, 30 year first mortgage loans held on the balance sheet have a risk weighting of 0.5. Those same pool of loans held in a liquid security issued and guaranteed by Fannie Mae have a risk weighting of 1.5 or more. We fail to see how the investment security is more risky than the loans when both are backed by the same pool of loans. To shed light on this discrepancy, perhaps the NCUA could be more transparent with risk weightings and share the contributing components of risk in each risk weighting. To our point about how the rule puts credit unions at a competitive disadvantage, the same security has a 0.2 risk weighting for banks under Basel III.

Another example of how interest rate risk is inconsistently applied for assets involves US Treasury Bonds. Take for example a 30 year US Treasury bond, its price declines by approximately 70% in a +300 basis point rate increase, yet it receives a zero risk weighting. Compare this to non-callable 3 year US agency debt with a 0.75 risk weighting that only declines 9% in a +300 basis point shock. Over a 3 year horizon, the 3 year US agency debt has no price volatility. The same cannot be said for the 30 year Treasury.

It is interesting to note that investments in the 5 to 10 year category have the same 1.5 risk weighting as a delinquent loan. In our opinion, loan delinquencies have been the primary cause of financial

institution failures throughout history. When has the ownership of non-callable 6 year US government agency debt resulted in the failure of a credit union? Yes, Corporate Credit Unions suffered investment losses, but not because of the term of the investment or interest rate risk. The losses were primarily due to the high loan delinquency rates on non-agency 1st mortgage pool investments.

Ownership of investments has actually strengthened many credit unions during periods of market crisis and low loan demand. After all, some credit unions only have charters for select employer groups with an older and/or more conservative work force that has more need for deposit products than loan products. What is a prudent credit union to do when faced with rising operating expenses? We have witnessed how some credit unions have fallen below "well capitalized" over the past several years when they took too little investment interest rate risk relative to the duration of their deposits. While we are not advocating the proverbial "investment club" backed by deposit insurance, investments do have a role to play, even long term investments in limited concentrations.

We believe that if interest rate risk is included in investment risk weightings, it should also be included in loan risk weightings. If the same approach used to set the investment risk weightings is applied to loans, the credit union industry as a whole may very well be undercapitalized. We don't believe that is the case because the NCUA's evaluation of interest rate risk at a snapshot in time, for one rate scenario, using only base case average life, and only considering price risk is inadequate in our opinion. In our opinion, interest rate risk should be measured on a total return basis (income and price change), over an appropriate horizon (1 to 3 years), and in a variety of interest rate scenarios. Importantly, most loans and investments shorten with the passage of time and benefit from "rolling down the yield curve". Also, amortizing loans and investments provide cash flow to put back to work in rising rate environments.

With the inconsistency in which interest rate risk is considered in this rule, there is a perverse incentive to ignore liquidity risk and move credit unions toward 100% loan to share ratios and longer-term zero risk weighted assets. On a related subject, we ask that the NCUA consider expanding the list of permissible investments for Federal Credit Unions to include such things as short term corporate debt, auto loan asset backed securities, among other things. This would allow Federal Credit Unions to diversify away from solely taking interest rate risk with investments to earn an acceptable risk-adjusted return.

Further, if interest rate risk is going to be considered on the asset side in this rule, then we believe it should also be considered on the liability side as well if the NCUA's goal is to comprehensively evaluate interest rate risk. The risk represented by a five year asset funded by sticky checking deposits is quite different than one funded by brokered CDs and high cost money market accounts. Perhaps there could be a capital credit given for checking and savings non-maturity deposits.

We would also ask you to consider lowering the risk weighting on Mortgage Servicing Rights because they are a natural hedge to the remainder of the credit unions balance sheet and operations. In a rising

rate environment, they appreciate in value. In a declining rate environment, their depreciation in value is offset by higher fee income from loan refinance activity.

We also do not believe that the NCUA should have made the risk based capital calculator results for individual credit unions public until such time as the results are more than just estimates. For example, risk based capital cannot be calculated properly until such time as there is a call report item that captures the amount of 2nd lien loans in which the credit union is also the 1st lien holder.

We appreciate your consideration of our input. Please let us know if you have further questions or would like to discuss these issues further.

Sincerely,

Daniel Zaczkowski
Executive Vice President
Chief Financial Officer