Advantage one
Federal Credit Union

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

In Reference To: Prompt Corrective Action Risk-Based Capital Proposed Rule

Dear Mr. Poliquin,

As a federally chartered, federally insured credit union of $116 million in total assets, Advantage One Federal Credit Union (we/us/our) has a vested interest in commenting on the National Credit Union Administration's (NCUA) recently proposed Prompt Corrective Action Risk-Based Capital (RBC) rule. We certainly appreciate the opportunity to provide our comments and trust that these will be carefully considered among others, as it pertains to this proposal.

Prompt Corrective Action Risk-Based Capital Thresholds

We feel that the RBC thresholds are set too high. Unlike banks, Congress has limited the definition of net worth for federally insured natural person credit unions, as you have acknowledged, as well. As you are aware, essentially a credit union is relegated to having only retained earnings as its composition of capital in the calculation of the proposed RBC rule. As it stands, not much has changed for credit unions greater than $50 million in assets with respect to including other components in its capital in the calculation of the proposed RBC rule.

It then makes little sense to go from a relative calculation that made up the RBNW, as an example, a credit union with a RBNW ratio greater than 6% is currently considered complex and, therefore, must maintain a net worth ratio at least equal to its calculated RBNW ratio, to a higher static limit that the credit union must now attempt to meet. If little has changed in what credit unions can include in its capital calculation, the proposed RBC thresholds should be lowered because of the limited flexibility credit unions have in meeting the proposed requirement.

Natural person credit unions have done a magnificent job overall in navigating through the Great Recession, the cause of which was not the result of any negligence or failures of the credit union industry. When compared to the banking industry, failing credit union institutions were minimal and credit unions even propped up the corporate credit union industry and covered the Share Insurance Fund; all while maintaining very good capital overall. In light of these facts it makes sense that implementing lower capital standards under the proposed rule would not pose unnecessary risks to the Share Insurance Fund.

Our proposal for the new RBC standards should be:

- Well Capitalized – 8.5% or greater
- Adequately Capitalized – 6% to 8.49%
- Undercapitalized – less than 6%

Risk-Based Capital Risk Weights

We feel that the proposed risk weights of the rule are too onerous. These in its current form will serve to make it that much more difficult to maintain the proposed RBC requirements at those higher categorical levels. Consequently, an affected credit union's ability to serve its members will be greatly impacted as it attempts to avoid concentrations at the higher risk weights for the sole purpose of maintaining well capitalized or even adequately capitalized status. As an example, credit unions will begin to avoid:

- Making loans with credit paper grades less than 'A'. It was noted that the category of 'Reportable Delinquent Other Loans' under the proposed rule had a significantly higher well capitalized requirement (15.75%) relative to the current requirements of 6%. Even the proposed adequately capitalized requirement was double the current requirement at 12%. When compared to the small bank Basel III model NCUA's proposed capital requirements are 1.5 times higher than the risk weights and capital requirements of the small banks. This gives banks in local markets an unfair advantage if credit unions that are subject to the proposed RBC rule withdraw from lending to its members at lower paper grades for the sake of compliance with this PCA. In addition, credit unions are truly not serving its entire membership if it restricts its lending in this manner for the sake of meeting a threshold. At a minimum, the proposed risk weights and capital requirements for this category should at least match those of the small banks under Basel III.

- Serving the membership through its business needs to avoid higher concentration levels. Similar to the 'Reportable Delinquent Other Loans' category, the concentration categories for 'Member Business Loans' are much higher than the current requirements and even the small banks under Basel III. Similar to 'Reportable Delinquent Other Loans' the proposed RBC requirements are 1.5 times higher for those concentration limits of between 15% to 25% of assets, and twice as high as small banks for concentrations greater than 25% of assets. Credit unions will withdraw from originating member business loans, which means it is not truly serving its membership while banks step in and take the market share. At a minimum, we feel that the proposed risk weights and capital requirements for these concentration categories should at least match small banks under Basel III.

- Purchasing investments greater than 5 years. When observing the proposed risk weights and capital requirements of the RBC rule relative to small banks under

Basel III, the differences are much more onerous for affected credit unions. Small banks under this standard carry a 20% weight across the board, including 1.6% and 2.1% capital requirements for adequately and well capitalized statuses, respectively. The proposed RBC rule starts with this risk weight and capital requirements for those investments less than one year, but then moves aggressively higher. Investments with a weighted average life (WAL) of between 5 -10 years have a risk weight of 150% and capital requirements for that category of 12% and 15.75% for adequately and well capitalized, respectively. It is even higher at 200% risk weight for investments with a WAL exceeding 10 years. These much higher, onerous risk weights and capital requirements forces affected credit unions to place excess funds in primarily shorter term investments earning little yield. For those credit unions with lower efficiency ratios they will sacrifice the opportunity cost of higher returns for lower ROA, which will eventually result in lower net worth, but a higher RBC.

Our credit union conducted an analysis of the peer credit unions in our local market and the effect that the proposed RBC rule would have on these relative to our own. We found that those peer credit unions that were deemed conservative, indicating those that invested in shorter term 'plain vanilla' instruments such as certificates of deposit, had lower loan-to-share ratios and did not engage in much member business development, typically had much higher calculated RBC ratios. Some of these were credit unions that had higher double-digit net worth to begin with.

However, another analysis we conducted with these peer credit unions compared the last 10 years of our investment yield to their average and it was discovered that we realized $4.8 million more in investment income over the last decade than the peer average. That represents nearly a half million dollars per year for a decade that the peers as an average left on the table. With these higher proposed investment risk weights, it will force credit unions similar to us to move more conservatively into shorter term securities for the sole purpose of reaching or exceeding a threshold, which makes little business sense.

Proposed Risk-Based Capital's Effect on Business Models and Operations

Our own net worth ratio as of the last Call Report was 10.1% with a RBNW ratio of 7.9%. With the proposed RBC rule our calculated ratio was 10.97%, which was not a lot of cushion at 47 basis points over the proposed well capitalized requirement. Our credit union has three branches and an overall lower loan-to-share ratio of under 50% that we are seeking to grow. We would like to have an eventual 70% loan-to-share ratio. This was felt to be a level that would comfortably cover our operational costs in an environment where the net interest margin has been progressively squeezed.

We discussed relaxing underwriting standards to allow for more credit grades of paper consisting of 'B' and 'C' while managing the risk of higher delinquency that might develop.

As a credit union with a lower loan-to-share ratio, the investment portfolio becomes increasingly important as a supplemental source of income, as indicated earlier. This might involve some investment in longer term assets that behave similar to loans in terms of amortization and the payback of principal with interest income, which is supposed to occur when liquidity is more abundant.

Our credit union has discussed more active involvement in member business loans, as well. These operational objectives are all hindered with the onerous risk weights and the higher capital requirements. If natural person credit unions had failed on a mass basis during the Great Recession or demonstrated they lacked the knowledge or capability to manage risks on a macro basis, it could be understood why these proposed requirements are so stringent.

However, when the purpose is to come on board with other banking industries, but then proceed to burden credit unions onerously as if the credit union industry was the cause of the fallout of the Great Recession, it makes little sense. Credit unions have proven through the last six years how prudent their business management and skills are by the lower number of failures that occurred through the recessionary period relative to banks.

Matching Sources and Uses of Funds

It does not appear that the proposed RBC rule effectively considers the credit union's liabilities as a source of funds matched against its assets. Understandably, it is critical to guard against interest rate risk and not accumulate heavy concentrations in longer term assets from an ALM perspective. However, with respect to our credit union we have a current asset yield of 3.37% and a NIM of 3.11%. Our cost of funds is just 0.29%. Our NIM, while it has decreased moderately over the past several years as the result of a historically low interest rate environment, has been consistent as a trend for two decades. The cost at which we are able to borrow funds to then loan out or invest has been very low and has always carried a healthy spread. The proposed rule does not factor this in, but appears to penalize a credit union on the asset side of the balance sheet irrespective to its management of matching sources and uses of funds.

Conclusion

The impact of the proposed RBC rule on affected credit unions could be devastating. NCUA quoted a study that 90% of affected credit unions would meet the minimum requirement if the rule was enacted today. However, this looks at a static point in time, but does not consider the dynamics of a credit union one, two, three or more years out. Business models and strategies perpetually change and evolve. The marketplace has become so competitive that the need for constant adaptation has become a way of life. One can look as close as the credit union industry and observe all of the mergers and consolidations that have taken place and that will continue to take place in the near future.

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This is because the environment has become so competitive and regulatory compliance has become so costly. The proposed RBC rule in its current form does not in any way help affected credit unions gain a competitive edge or manage its ever-increasing compliance costs. It places a huge burden on top of a load of existing burdens for those affected credit unions. We believe that NCUA should take a serious and hard look at reducing its capital requirement categories as indicated above; in addition to reducing the proposed risk weights for those categories discussed in detail above.

If left in its current form, the RBC rule would leave credit unions at the mercy of its competitors while they gained market share and, even worse, force affected credit unions to ignore many of its members; which is not consistent with the credit union philosophy. NCUA in effect would be forcing the operational decisions and strategic objectives of board members and management teams, which is not and should not be its role. NCUA would have also directly forced more mergers with this proposal, as we feel that this would be an inevitable result over time.

Another critical point is the detrimental impact this proposed rule will have on those credit unions who have consistently maintained a Camel '1' or '2' with respect to their statutory net worth. Under the proposed RBC rule these credit unions will find a shift for the worse. Whereas before they were being lauded by their examiners for maintaining excellent net worth and now they can easily be found undercapitalized even though their net worth position has not changed. Examiners have already indicated that falling even into the adequately capitalized category is one that a credit union does not wish to be in. This is not reasonable, which is why we feel the proposed standards we suggested on page 2 above be put into place. Our recommended standards are more realistic and will not result in a drastic shift from excellent capitalization to a credit union being adequately capitalized or even worse, undercapitalized.

Credit unions have proven in the last recession what prudent and resourceful decision-makers they can be. It makes little sense that these capital requirements in its current form would be proposed. We respectfully request that NCUA take a serious look at this proposal and strongly consider the detrimental and lasting effects that it could and would have on the credit union industry.

Respectfully Submitted,

Christopher Corkery, CEO

Cc: Richard Lindemann, Board Chairman

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