Pittsburgh CENTRAL FEDERAL CREDIT UNION

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May 2, 2014

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

RE: Comment to the Proposed Prompt Corrective Action – Risk-Based Capital Regulation

Dear Mr. Poliquin:

On behalf of the Board of Directors, staff, and membership of the Pittsburgh Central Federal Credit Union, I would like to provide the following official comment letter regarding the NCUA's recently proposed risk-based capital rule. Although I understand that we will not be subject to this rule since we are currently under the $50MM cap, it is not unrealistic with today's growth patterns that we will reach this cap in the next few years.

The statutory net worth requirement of 7% was not set by empirical studies but rather was a negotiated term in the passage of the Credit Union Membership Access Act. Bankers who have a lower net worth requirement wanted to set a high net worth requirement for credit unions to slow the growth of credit unions. NCUA is now proposing to build upon that artificially high net worth requirement that will only serve to enhance the banking industry's goal of retarding the growth of credit unions for competitive reasons. We do not object to additional capital requirements for some credit unions if justified by higher risks, but the risk levels should be established with this historical perspective.

We note that, while perhaps imperfect and indeed "one size fits all" in its approach, the current 7% net worth requirement was sufficient to sustain the credit union industry through the recent financial crisis, and credit unions did not require a taxpayer bailout.

Regarding business loans are risk rated at 100%, 150% and 200% depending on the percentage of assets that business loans represent in the credit union, there are several aspects of this we do not understand. Why are business loans given different ratings based on the percentage of assets they represent? While we expect that the answer may be based in a concern over concentration risk, we call to your attention in the name of "comparability" that banks do not have such a tiered risk weighting system based upon percentage of assets. They address concentration risk through the examination and supervisory process, not the actual risk weight in their capital system.

The banking regulators recognize, as should the credit union regulators and insurer, that an individual business loan's risk does not change based on the number of other business loans the credit union is holding. The risk weight should be equal for all business loans and any concentration risk issues should be addressed through supervision and examination.

We would also point out on behalf of ourselves and other credit unions with ownership interests in CUSOs that this system, if implemented as proposed, would very much disproportionately impact those credit unions that are traditionally business lenders and have lending portfolios that are primarily or exclusively business loans – whether they do so through the credit union or through a CUSO.

There seems to be no consideration given for the risk of types of business loans. For example, the risk of a mortgage loan in a commercial property at 50% LTV in a stable economic market is certainly much less than a loan secured by inventory that turns over quickly yet the risk rating is the same. Yet, there is no consideration for the difference in risk among business loans, nor is there any credit provided from the risk weights based upon the historical and current performance of a credit union's business loan portfolio. In our view, if a credit union has a proven history of low delinquencies and charge-offs in its business loan portfolio, that performance history – easily verified through the same 5300 Call Report data as the other numbers in the formula – should be incorporated into the system in a manner that will result in a lower risk rating than would be the case in a credit union with higher delinquencies and charge offs currently and over recent years.

We still see value in the statutory net worth level established by law at 7% reserves to total assets. We would expect that Congress, which passed this standard in 1998, also sees value in that standard. Therefore, we would recommend that any credit union with over 7% net worth as a percentage of total assets that fails to exceed its required risk-based capital level under this proposed regulation be given consideration in any proposed corrective action required under the risk-based capital regulation.

We strongly encourage NCUA to limit the remedy in such cases to a capital restoration plan that allows the credit union a reasonable and appropriate period of time to improve its risk-based capital ratio – even as they maintain their statutory net worth ratio above 7%. In our view, the draconian measures that can be used by law and regulation in a prompt corrective action are not appropriate when the statutory minimum of 7% net worth is met, even if the risk-based capital ratio is below 10.5%. Any corrective action removing volunteers, dismissing management officials and severely restricting business options is an unwarranted overreach for a credit union with over 7% net worth. The 7% net worth level is a well-established and conservative statutory requirement that has been in place and managed for over fifteen years.

In our view, the mortgage servicing risk rating of 250% is likewise excessive. There is an active market for mortgage servicing rights which have established values and do not deserve a high-risk rating. The high-risk rating could discourage loan participations. Without loan participations, many credit unions would not have sufficient interest income to survive. We strongly encourage NCUA to reduce this risk rating significantly. When compared to other risk ratings, we recommend 100%.

We also believe that the CUSO investment risk metric of 250% is excessive especially as compared to other risk ratings. For example, delinquent consumer debt over sixty days as well as delinquent unsecured credit card debt is risk rated at 150% and delinquent first lien mortgage loans are risk rated at 100%. Yet investments in CUSOs that have added millions to the bottom line of credit unions are arbitrarily deemed riskier. We do not understand this reasoning.

CUSOs provide a wide range of services. The one-size-fits-all CUSO risk rating does not take into consideration (a) what types of services are being provided, (b) whether the investment represents necessary operational expenses that would be otherwise incurred, (c) whether the amount invested is material, (d) whether the CUSO has a history of profitability, or (e) whether the investment amount has been fully recovered by the credit union through savings or income. Even if there is a risk assessment for the initial CUSO investment, there is no reason to continue to have a risk assessment if the amount of the investment has been fully offset by net income or cost savings for the credit union that was generated by the CUSO.

While there are some CUSOs that are designed to return a profit through dividends, many CUSOs provide a return to the credit union owners by the reduction of operating costs or fees paid directly to the credit union in the form of networking fees and not dividends. NCUA's choice of equating a CUSO to a bank investing in an illiquid small business, misses the true risk and return factors. For example, when a credit union is deciding whether to pay the expenses for running an operational service through the credit union or its CUSO, money has to be expended by the credit union either way. If multiple credit unions pool their funds in a CUSO to provide an operational service, it is because each credit union will save money, and often receives greater expertise than they could afford on their own. Why must risk capital be reserved by the credit unions in order to save money and generate net income?

We have been advised that NCUA intends to apply the CUSO capital risk rating to both the cash investment made by the credit union *and upon the appreciated value in the CUSO.* We find it hard to fathom that NCUA would penalize the success of a CUSO by requiring that the credit union reach into its pocket and set aside additional capital on the profits earned by the CUSO.

Unlike the banking investment powers, the CUSO risk exposure is limited to an immaterial level. There are only 22 basis points of credit union assets invested in CUSOs industry-wide; less than the aggregate corporate assessments. Each federal credit union may only invest less than 1% of assets in CUSOs. Credit unions could lose all their CUSO investments and the loss would not be material yet the upside potential could be very significant. NCUA would be making a big mistake by not recognizing the adverse policy implications of applying the inconsistent BASEL bank investment risk ratings to CUSO investments.

In addition to the above referenced concerns about the risk weighting of CUSO investments, we are also very troubled by proposed Section 702.105(c). Unlike under the existing statutory net worth rules known as Prompt Corrective Action (PCA) regulations, credit unions will no longer have clear rules by which to run their credit union to avoid prompt corrective action by their regulatory agency. NCUA can "move the goalposts" any time they want. Why have any tables of risk rating if the levels can be changed on a credit union by credit union basis?

This proposed section invites inconsistent and potentially arbitrary applications of rules. To provide the clarity of capital and net worth expectation that a credit union board and management team must have in order to make strategic business and fiduciary decisions, subjective standards must be eliminated. Therefore, in our view, Section 702.105(c) should be deleted in its entirety.

We know first-hand of the struggle credit unions have to generate net income in today's economic climate. Interest rates are at record low levels. The operational costs, especially in areas of personnel costs, compliance and technology, are increasing exponentially. Coupled with the challenges most credit unions are experiencing in generating quality loans, the average net interest margin in the industry is very thin and in some credit unions the net interest margin is even negative.

The true risk is not the investment or loan to a CUSO, rather it is *not* investing in a CUSO to share risk, reduce costs and increase income. We encourage NCUA to implement regulations that encourage the use of CUSOs to generate net income and remove all regulatory impediments to CUSOs and collaboration. We recommend the removal of risk ratings for CUSO investments and loans as immaterial, inapplicable to CUSO investments and to encourage CUSO investment for policy reasons.

Also concerning to us is that the proposed implementation date of this rule is eighteen months after final passage. This is an unreasonably short time period considering the long term and significant impact of this new rule on credit union strategic business decisions. Credit unions have very limited means to raise capital under present statute and regulation. It will necessarily take a considerable amount of time to make adjustments within the balance sheet when the rules are suddenly changed. We recommend that an implementation period of no less than three years from final passage is much more appropriate. Again, in the interest of comparability, this is much more consistent with the timeframes given the banking industry as their regulators have implemented the BASEL capital standards; even though they have more access to capital management and capital building options than credit unions.

Finally, the introduction of a risk based capital system requires more options for all credit unions to raise supplemental capital. We encourage NCUA to accelerate the efforts to implement supplemental capital options for all credit unions, in conjunction with the Risk Based Capital Rule implementation, providing an important tool for those credit unions that will no longer be well capitalized as a result of this rule and for others that need strategic options to assist them in managing to the new risk based capital standards. As some commentators have suggested, we believe NCUA has the power to authorize supplemental capital for risk-based capital purposes.

Thank you for the opportunity to comment.

Kind regards,

Patricia L. Morrissey,
President/CEO

CC: PCFCU Board of Directors
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