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

May 9, 2014

Re: RIN 3133-AD77

Dear Mr. Poliquin:

The opinions expressed below are those of the undersigned who is currently the CFO of Picatinny Federal Credit Union, Dover, New Jersey. They are not necessarily the opinions of the Directors, Officers, Employees, Volunteers or members of Picatinny Federal Credit union.

I will note at the start that I have long been a supporter of risk based capital standards. Unlike many of my colleagues I believe the current net worth ratio alone is totally insufficient to provide the degree of protection against potential losses that a proper risk based capital ratio does.

In the section, *Why is the NCUA issuing this rule?* The first paragraph states "*the proposed rule reflects an effort to establish a risk weighting system that is more indicative of the potential risks existing within credit unions*."

There currently is an existing risk weighting system that captures these risks. It is the risk based capital standards that are currently being adopted by community banks under Basel III. The risks of community banks and credit unions are as similar in nature as to be almost indistinguishable. It is puzzling why the NCUA needs to create its own risk based capital guidelines.

That being said I believe the proposal as it is currently written requires some significant adjustment to provide for both the protection of the NCUSIF and at the same time give the ability to credit unions to provide needed affordable services to their members while supporting the nation's economic growth.

Within the same section it states *"This proposal seeks to incorporate the lessons learned from those failures and better account for risks not addressed by the current rule."*

This is where the NCUA always seems to be fighting the last battle. For example, while there is a need to address and control interest rate risk within the context of the entire balance sheet, the risk based standards place too much emphasis on maintaining a short investment portfolio (less than three years). The concern, of course, is a rapid spike or shock in interest rates. Such shocks have occurred in the past. However, the last time shocks of 200 or 300 basis point in a given month took place was from March 1980 until November of 1981 (a period of 21 months). Such shocks have never occurred before that time. We are currently in an environment where short term investment rates are at or near zero percent. The federal funds rate was set to zero in December of 2008 and has remained at that level at this writing (a period of 64 months with no predictable ending date). During that time our members at

Picatinny Federal Credit union deleveraged their borrowings such that loans are less than 40% of assets and our investment portfolio, which makes up much of the remainder of the balance sheet, is now yielding close to 1% and declining. Our profitability is marginal and at times has been in a loss position. The net interest margin declined by over 160 basis points during this period. In hindsight, a longer investment portfolio would have benefited us during this period and allowed us to generate more capital instead of seeing capital decline. It could be argued that the prolonged period of near zero interest rates and low loan demand we currently have are worse for financial institutions than any increase in rates. This risk based capital proposal only addresses one side of the balance sheet with respect to interest rate risk. There is no credit given for credit unions with long term liabilities. Controlling interest rate risk through risked based capital is not workable.

In this same vain it is understood that the current crisis was caused by a collapse of the real estate market. The collapse in real estate was caused in part by placing unqualified borrowers into mortgage products they did not understand. Not all credit unions were lending on this basis. Many did only conventional lending with acceptable credit standards. Such a crisis in real estate had not occurred since the Great Depression. While many credit unions experienced significant real estate loan losses during this period, our credit union did not. The new standard requires higher levels of capital for larger proportions of first mortgage and home equity loans. In normal times these loans would be considered the most secure from a credit standpoint and indeed they are. These same levels of capital do not apply to lesser secured loans such as unsecured personal loans and credit cards. Unsecured loans carry the most risk regardless of economic conditions. Community banks have the same risk weighting for real estate loans regardless of concentration. Subprime and delinquency are given a higher weighting then prudently underwritten loans for community banks. Credit unions could be placed at a competitive disadvantage with regard to pricing if more capital is needed to support its real estate lending.

It is one thing to learn from the past, but the past does not always repeat itself. Unintended consequences of the new guidelines could cause the next crisis.

Proposed 702.104(b)(1) Elements of risk based capital numerator. The change making the ALLL a part of the numerator in risked based capital is long overdue and the NCUA finally recognizes that this is a reserve to absorb losses and not an asset contra account. The limit of 1.25% of assets seems adequate.

Proposed 702.140(c) It is noted that this section *would address concentration risk by assigning higher risk weights to larger percentages of assets in MBLs and real estate loans.* This is a clear prejudice by the NCUA regarding these types of loans. As stated previously, when done with the proper standards to truly qualified borrowers real estate loans can be the most solid from a credit risk standpoint than almost any other type of loan. The other regulatory agencies understand that and risk weigh them accordingly regardless of concentration. MBLs carry more risk than real estate loans but when done properly can be more credit worthy than unsecured loans such as unsecured credit card, personal loans or overdraft lines of credit. Credit card and unsecured loans carry a risk rating of only 75%. One of the unintended consequences of the proposed rule would be for credit unions to engage in balance sheet concentrations of this type of riskier unsecured lending leaving them greatly exposed in the next economic downturn.

During the Great Recession the vast majority of our loan losses were in the form of unsecured personal and credit card loans. The second largest losses were in a product called a “little or no equity loan”. These made up a very small portion of the loan portfolio. Our regular First mortgages and Home equity loans which combined make up over 30% of total assets had *cumulative* losses over the five year period 2008-2012 of .29% and .56% other their average balances respectively (miniscule).

Home ownership and subsequent home improvements are major drivers in the economy. The proposed rule would restrict credit union's ability to provide their members with very necessary funding in this area and put them at a competitive disadvantage with banks that do not have the same concentration restrictions. The proposal states that, "*The concentration threshold amounts are generally based on the average percentage of assets held in these asset types."* The word "generally" appears to indicate the arbitrary nature of this determination.

Table 7 proposed risk weights for cash and investments. The proposal states "*The proposal would lower the risk weight for unconditional US Government obligations (FDIC Issued Guaranteed Notes, and other US Government obligations) from the weighted average life measure to zero risk weighted assets".* One would assume that this would mean these would have zero risk weighting regardless of maturity. The proposal is unclear. That would also raise the question of GNMA mortgage backed securities. These are unconditionally backed by the full faith and credit of the US Government. Does investment in these securities also qualify for the zero risk weight? Likewise, an investment in a FDIC insured certificate of deposit at another financial institution up to $250,000 also has the full faith and credit guarantee and therefore should also qualify for zero risk weighting regardless of maturity. Again the proposal is unclear.

The NCUA has a great opportunity in light of the recent crisis to adjust the risk weighting with regard the maturities in the portfolio. As I stated previously the current zero level of interest rates has persisted for 64 months at this writing (over 5 years). Because many credit unions maintained investment portfolios with maturities 3 years or less our investment yields have averaged 1% or less for the past two years and may remain so for the foreseeable future. Under the proposal investments have a 20% risk weight for maturities less than a year. That risk weighting jump significantly to 50% for >1year and < than 3 years. This drastic increase in the risk weighting does not seem commensurate with a maturity horizon that extends to 36 months maximum. That maturity horizon by almost any definition would not even be considered intermediate term much less a long term security.

The risk weight then jumps another 50% to 75% for securities >3 years and <5years. This is by most definitions an intermediate and not a long term security. It also brings up an issue that I have raised previously. An investment with a 37 month maturity has the same risk weighting as an unsecured credit card, personal, loan or overdraft line of credit. These loans carry significantly more credit risk and are in many cases less liquid from a maturity standpoint than the investments.

I would suggest that the NCUA change the risk weighting of investment securities be based on the credit risk of the security and not its maturity. Community banks do not use maturity as a risk weight measure. Interest rate risk must be managed in the context of the entire balance sheet. Isolating one area of the balance sheet for additional risk based capital due to perceived interest rate risk (i.e. assuming the only risk is rates increasing); seems to miss the real goal of interest rate risk management.

Assigning a risk weighting of 250% to mortgage servicing assets seems both arbitrary and overly stringent. It is understood that they become impaired when rates fall and borrowers refinance or repay their mortgage loans. While this can cause some earnings volatility the risk here is greatly overstated. Proper modeling and validation mitigate these risks.

In assigning risk weights for off balance sheet activities proposed 702.104 (b) (3) assigns a 75% conversion factor with a 50% risk weight for first mortgage real estate loans transferred with limited recourse. Our credit union sells loans to the Federal Home Loan Bank of New York under their MPF program. The underwriting standards are very conservative and the credit unions must share in the credit risk by credit enhancements secured by stock and collateral. The FHLB assumes responsibility for the first layer of losses. While there is recourse to the credit union, the amount of actual losses during the recent real estate crisis to the entire MPF system was miniscule. The NCUA should get more information on the FHLB MPF program before finalizing the proposed risk weights to include an exception for those credit unions participating in the MPF program or at least assign a lower risk weight to the loans. The proposal attempts to limit the amount of first mortgages carried on a credit union's balance sheet. At the same time it also tries to limit the amount of loans that are sold to third parties even with very limited recourse. The unintended consequence of these actions will be to limit a credit union's ability to provide affordable first mortgage loans to its members and strengthen a very important sector of the nation's economy.

Proposed 702.104 (c)(2)(x) would require that a credit assign a risk-weight of 1,250 percent to 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. Assuming that the examiner on site is the one making the assessment as to "comprehensive understanding" would it not be prudent to have the credit union divest itself of such holding rather than capitalize 100% of the investments balance sheets value.

Please consider these comments prior to issuing the final ruling.

Respectfully

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