TUCOEMAS
FEDERAL CREDIT UNION

May 8, 2014

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

Re: Comments on Proposed Rule: Prompt Corrective Action – Risk-Based Capital

MAY12'14 PM 2:38 BOARD

Dear Mr. Poliquin:

I am writing this on behalf of the management and members of Tucoemas Federal Credit Union in Visalia, California. We appreciate the opportunity to comment on NCUA's proposal relating to risk based capital. Tucoemas is a federally chartered credit union with $200 million in assets and 33,000 members. Our Net Worth and Risk-Based Capital (proposal) ratios are 7.64% and 13.40%, respectively, as of March 31, 2014. Tucoemas supports the concept of risk-based capital and believes credit unions should maintain levels of capital that are commensurate with their level of risk. However, we are deeply concerned that the current proposed rule will not achieve this objective and may actually cause more harm than good. We believe there are serious flaws with the proposed risk-based capital regulation that could have negative consequences on credit unions' risk management and ability to stay relevant to members. These flaws are in the form of inconsistent and arbitrary treatment of interest rate risk, credit risk, and liquidity risk on asset risk weightings, as well as no recognition of liability management and issues related to the treatment of the Allowance for Loan Losses, Investments in CUSOs, Goodwill, and NCUSIF.

Confusion and Inconsistency with Interest Rate Risk, Credit Risk, and Liquidity Risk The proposed regulation is inconsistent and arbitrary in the risk-weightings related to interest rate risk, credit risk and liquidity risk.

- Investments with longer lives are assigned higher risk weights reflecting greater interest rate risk and liquidity risk, yet U.S. Government obligations and NCUA guaranteed notes (NGN) securities are assigned a zero risk weight apparently due to their lack of credit risk. It's hard to understand why a 30-year Treasury bond would be considered less risky than a two-year agency security or overnight federal funds. Does the lack of credit risk in Treasury and NGN securities somehow nullify interest rate risk? It appears a credit union could load up its balance sheet with long-term fixed rate Treasury securities and enjoy a positive impact on risk-based capital relative to holding the same amount in overnight funds.

- Mortgage-backed securities (MBSs) and collateralized mortgage obligations (CMOs) are risk weighted based on their current weighted average life. For many MBSs and CMOs it does not take much of an increase in interest rates to extend the life of a security, thereby possibly moving it to a higher risk weighted investment classification. Accordingly, MBSs and CMOs will likely contribute volatility to risk-based capital under the proposed regulation.

- Real estate loans at greater concentration levels receive higher risk weightings up to 100%. However, it is not clear whether this is being driven by concern over interest rate risk, credit risk, or liquidity risk (or all three risks). To the extent that it is interest rate risk, we believe it would make more sense to differentiate real

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estate loan risk weightings based on fixed vs. adjustable rates, in lieu of portfolio size as a percent of assets. A further refinement related to credit risk would also be to differentiate real estate loan risk weightings based on current loan-to-value ranges.

- Consumer loans are assigned a higher risk weighting than real estate. This is confusing since, due to their shorter terms, consumer loans carry lower interest rate risk, liquidity risk, and varying credit risk levels depending on borrower creditworthiness and underwriting practices. It would make more sense to differentiate consumer loan risk weighting based on credit score ranges (e.g., 720 and over = 50%, 680-720 = 75%, 600-680=100%, 600 and below = 125%).

Overall, we encourage you to provide transparency, rationality, and consistency in how assets are weighted for the various applicable risks.

No Recognition of Liability Management The proposed rule does not address the liability side of the balance sheet. This is troubling since liability strategy plays a key role in a credit union's management of interest rate risk and liquidity risk. In essence, the proposed rule penalizes credit unions that mitigate their interest rate risk and liquidity risk by proactively managing their liability structure (e.g., maximizing core deposits, matching FHLB borrowings to real estate loans, etc.) and effectively rewards credit unions that have no liability strategy.

Allowance for Loan and Lease Losses (ALLL) The ALLL is an element of capital in the proposed regulation. However, it is limited to 1.25% of risk assets in how much can be included in the capital calculation. This limitation will become problematic and reduce most credit unions' capital once the Financial Accounting Standards Board's current expected credit losses (CECL) accounting requirement goes into effect. Current estimates are that most financial institutions will need to raise their ALLL by at least 50% when they adopt the CECL accounting methodology. The 1.25% of risk assets limitation will mean that a significant portion of the ALLL will be excluded from capital for many credit unions. We encourage you to eliminate any limitation on the amount of the ALLL that can be counted as capital.

NCUSIF Capitalization Deposit The NCUSIF Capitalization Deposit is also treated as a deduction from capital in the proposed regulation. This is another tacit conveyance of the idea that there is no real value in the NCUSIF Capitalization Deposit. Not only does this treatment fly in the face of GAAP, but it forces the issue that NCUA is trying to have it both ways when it comes to allowing credit unions to record the deposit as an asset while not counting it as capital. It should either be an asset and not deducted from capital or it should not be considered an asset at all.

We are submitting our comments with the expectation that it is in the common interest of all parties – credit unions, credit union members, NCUA, and NCUSIF – to have a rational risk-based capital regulation that is consistent with and encourages sound risk management practices and aligns well with business strategies for maintaining or increasing relevance to our members and communities.

Sincerely,

Michael Ryan

Michael Ryan
VP Finance
Tucoemas Federal Credit Union