LOC Federal Credit Union
Financially Fit Together℠

May 13, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street Alexandria, VA 22314

Dear Mr. Poliquin,

On behalf of LOC Federal Credit Union, I would like to offer the following comment letter on the recent NCUA proposed Risk Based Capital rule. We appreciate the concept of having lower risk-based capital requirements for credit unions with lower risk operations and requiring higher levels of risk-based capital for credit unions with higher risk operations. While our credit union recognizes the need for a well-balanced and credit union specific set of capital standards as an alternative to the current net worth requirement, we have serious concerns about the proposed Risk Based Capital rule that we feel must be addressed or the result could be a less workable capital standard putting the credit union charter at a disadvantage to our competitors. We would like to respectfully address the following concerns and offer recommendations to the regulation in these specific areas.

Concern:

First and second mortgages along with MBLs are weighted based solely on concentration risk. We understand that a larger percentage of these assets ***may*** result in additional risk, however the proposal ignores credit risk or any adjustment for LTV (Loan to Value) or other mitigating factors. One such factor is the mix of liabilities on the balance sheet which can offset risk from an asset-liability aspect. Lower LTVs, lower charge off ratios, higher concentration of member CDs or other non-maturity deposits, and hedged borrowings would indicate that risk is reduced or being compensated for. There should be a credit for some of these factors since risk is being actively managed and should be adjusted for and recognized.

Recommendation:

Reduce the risk weight by 50 bps if the charge off rate is below a certain threshold such as the average five year charge off rate. This will recognize strong underwriting and strong portfolio performance. In addition, consider applying weights based on concentration within LTV limits. For example, apply weights for percentage of assets with LTVs less than 80% and apply a higher weight for LTVs over 80%. It is understood that this would require additional reporting and recordkeeping by credit unions, however due to the importance of the risk based capital rule and prompt corrective actions that are associated; strong underwriting, strong performance, and actively managing your balance sheet should be a factor accounted for in the calculation.

Farmington Office: 22981 Farmington Road, Farmington, MI 48336 • Phone 248.474.2200 • Fax 248.473.8244
Hartland Office: 10002 Highland Road, Hartland, MI 48353 • Phone 810.632.3222 • Fax 810.632.3111
Howell Office: 3020 E. Grand River Avenue, Howell, MI 48843 • Phone 517.546.8390 • Fax 517.546.8369

800.837.4LOC (4562) • locfederal.com

Concern:

Current consumer loans are weighted at 75% risk weight. While we are in agreement that delinquent loans be weighted higher, the proposal does not take into consideration if the loan is secured or unsecured. It is a safe assumption that collateralized loans carry a lessor risk. This is ignored in the proposed rule.

Recommendation:

Assign a lower risk weight such as 50% for ***secured, direct*** **and** ***indirect*** consumer loans. Assign 75% to ***unsecured*** loans as they pose higher risk. Assign 100% risk weight ***to delinquent secured direct loans*** since they are collateralized. Assign 150% to ***delinquent unsecured and delinquent indirect loans***. It should be noted that we are recommending that ***current*** indirect loans be treated the same as direct loans , however we recommend that the higher 150% be assigned to delinquent indirect loans even though there is collateral. It would appear that this tracking information is already reported and categorized on the 5300 report and would not require any additional recordkeeping/reporting.

Concern:

Investments in CUSO are assigned a weight of 250%. This appears to be very high and in fact, would possibly discourage the collaboration that is the very intent of CUSO arrangements. Since it is based on the ***value*** of the investment, it appears that the credit unions would be penalized from the increased value. It is understood that the investment in CUSOs are not guaranteed funds, but it would appear that credit unions are unjustly penalized from these types of arrangements. CUSOs save credit unions significant dollars in operational costs and provide additional non-interest income that contributes to capital. In some cases, it allows credit unions to offer services to its members that otherwise they may not be able to do. Different types of CUSOs pose different types and degrees of risk. There is nothing in the proposal that would account for the different types of CUSOs.

Recommendation:

Consider lowering the risk weight to 100% for CUSOs meeting certain lower risk criteria. Possibly determine which CUSOs pose greater risk and assign a higher risk of 150% to those categories. For example, assign 100% to a data processing CUSO and 150% to a MBL CUSO recognizing the different types of risk associated. It would appear that the credit union's performance with CUSO activities is monitored during the examination process and potential risk issues could be addressed and managed through NCUA examination/supervision authority. 250% is too high and discourages the huge benefits that CUSOs provide. This can be hurtful to credit unions.

Concern:

The proposal allows for examiners to subjectively decide to increase a credit union's risk based capital ratio beyond 10.5%. This would appear that credit unions could be subject to arbitrary determinations and inconsistent applications of the requirement. In addition, a credit union would not be able to plan and strategize changes to their balance sheet if they have no concrete ratio to manage to.

Recommendation:

Remove the examiner's ability to arbitrarily require a different risk based capital ratio. As mentioned, problematic concerns that an examiner could have should be addressed and managed through NCUA supervisory authority.

Concern:

In order for a credit union to be considered well-capitalized under the proposal, the net worth ratio must be 7% or above ***AND*** have a risk-based capital ratio of 10.5% or above. We feel that risk-based requirement which is 3.5% above the net worth ratio is high.

Recommendation:

Reduce the risk based capital requirement from 10.5% to 9%. This is 200bps above the already high 7% net worth requirement and would be sufficient without prohibiting healthy growth.

Concern:

The proposal states that the rule will go into effect eighteen months after final approval by the NCUA board. This does not appear to be enough time for credit unions to adjust items based on the new requirements if necessary.

Recommendation:

Delay the effective date until three years after the finalization of the rule to allow time for balance sheet adjustments. This would give time for changes to be applied strategically over time and prevent quick, rash decisions in order to conform to the requirements over a shorter time frame.

Concern:

It is unclear on the PCA actions required if a credit union meets the net worth criteria for a well-capitalized credit union but not the risk based capital ratio. It appears the credit union would be considered adequately capitalized in this case, but we were not clear on what the PCA actions would be.

Recommendation:

We recommend that the remedy in these cases be to submit a capital restoration plan that allows a reasonable period of time (three years) to improve the ratio. Any other actions would seem unnecessary and growth prohibitive when net worth exceeds 7%.

We appreciate the opportunity to comment on this important NCUA proposal. Given the criticality and impact to credit unions, it is so important to have a rule that protects credit unions against risk without restricting healthy strategic growth.

Sincerely,

Kari Ciaramitaro, CPA
Executive Vice President
LOC Federal Credit Union