FIRST FINANCIAL
CREDIT • UNION

May 14, 2014

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

Re: Comments on Proposed Rule: PCA – Risk-Based Capital

Dear Mr. Poliquin:

First Financial Credit Union (FFCU) appreciates the opportunity to provide comments, observations, and recommendations to the National Credit Union Administration (NCUA) Board about the proposed rule on prompt corrective action (PCA) and risk-based capital. FFCU is a $435 million, 32,000-member federally insured California-chartered credit union located in West Covina, California. Our credit union exists to serve the educational community in California.

The credit union's board and management team understands the need for appropriate capital to be present to support the operations and risks of serving its membership. Risk-based capital analysis is an important measure to help understand that risks are supported with the required capital. However, the proposed PCA – Risk-Based Capital Rule, in its proposed current form, has several issues that could have serious consequences in the ability of the credit union to manage its balance sheet and ultimately serve its members.

Understanding that the NCUA wants to align capital measurements with others in the financial industry, it's important to remember that credit unions are not like other financial institutions in the sense that their balance sheets typically hold less risk than other financial institutions and most important their capital structure is completely different. The biggest difference may be that, currently, the only form of capital that most credit unions hold is in retained earnings. The ability for credit unions to adjust their capital position does not exist except through adding additional earnings. No method currently exists to add additional capital through other sources making the ability to increase capital a very timely process.

As mentioned earlier, there are several issues, and ultimately concerns, FFCU has with the current proposal. Below you will find the credit union's comments and recommendations on these issues.

Uneven Playing Field:

> **Escalation of Risk Weightings** - It appears that the NCUA is attempting to address items such as credit risk, liquidity risk, concentration risk and interest rate risk all in the same calculation. This is inconsistent with the Basel III Risk-based Capital calculation for other financial institutions which only focuses on credit risk. This leads to higher and

escalating risk based requirements which potentially will handcuff credit unions in the ability to serve its members. *FFCU recommends that the escalations of risk based requirements when mortgages and member business loans hit a certain percentage of assets be eliminated.*

Risk Weightings Higher for Credit Unions - There are several instances where the risk weighting requirements for credit unions, which typically have lower loss ratios than other financial institutions, are higher than the ratios for these other financial institutions. *FFCU recommends that the risk weights be the same as or below the Basel III requirements of other financial institutions for all asset classes.*

Roll-out Period - Other financial institutions will have as long as five years to meet the requirements of the risk based capital requirements under Basel III while credit unions will only have 18 months. This seems especially onerous to an industry that does not have the ability to raise capital quickly. *FFCU recommends that the roll-in period be aligned to at least the requirements of other financial institutions.*

Risk-Rating Inconsistencies:

There currently exist some inconsistencies in the proposal with regards to the assigned risk weightings between different asset classes. For instance:

Securities vs Mortgages - Long-Term Agency Mortgaged-Backed Securities have a risk weighting of 150% while riskier mortgage loans of the same average life have a risk weighting of only 50%. *FFCU recommends that the risk based weightings be further reviewed and adjusted to align the risk characteristics between different asset classes.*

FRB Deposit Balances - Deposit balances held at the Federal Reserve Bank have the same risk rating of 20% as deposits held in other commercial banks. The balances at the Federal Reserve Bank should have a 0% risk weighting, the same as all other U.S. Government guaranteed instruments. *FFCU recommends that the risk weighting for Deposits held at the Federal Reserve Bank be changed to 0%.*

Lack of Credit Consideration - The risk weighted requirement on all loans are the same regardless of credit quality. For instance, a 50% LTV mortgage to an A borrower has the same capital requirement as a D borrower with a 100% LTV loan. *FFCU recommends that consideration be given to adjusting the risk weighting based on the credit quality of the underlying loans.*

Other Major Items:

NCUSIF Capitalization - The elimination of the NCUSIF capitalization from both the asset and equity portions of the calculation is particularly disturbing. By eliminating the balance from both the asset and liability portions of the equation, the financial impact is the same as balance having no value and expensing the balance. If the NCUA believes this asset has no value then it should be expensed. However, in reality the balance does have value as the capitalization balance would be returned to the credit union if it decides to move away from the NCUSIF and move to a private insurer.

In addition, by eliminating the balance from both sides of the equation an argument can be made by an accounting firm that the balance should be expensed. For FFCU this would result in a reduction of approximately 90 basis points to the credit union's net worth ratio calculation.

FFCU recommends that the balance of the NCUSIF capitalization balance remains in both sides of the calculation.

ALLL Balance Limitation – the current limit of 1.25% of assets on the amount of ALLL that can be used in the calculation makes little sense. The allowance is the first line of defense for loan losses before capital is impacted. The greater amount of ALLL on the balance sheet, the greater protection there is for the capital balance. While this may not have a major impact immediately, if FASB passes the current credit loss proposal, ALLL balances will increase in the future making this limit a major issue. *FFCU recommends this limit be removed and the full amount of ALLL be allowed to be used in the calculation.*

Regulator Ability to Subjectively Increase RBNW requirement –The impact of subjectively overriding the standards set by the rule because the results do not satisfy the regulator view of the risk within a credit calls into question the calculation for all credit unions. The regulator has a multitude of mechanisms to use including examiner findings, documents of resolutions, letters of understandings, cease and desist orders, or even conservatorship of the credit union to enforce actions to change the risk of a credit union's balance sheet. *FFCU recommends that the standards established by the final rule stay as calculated and if the regulator has issues with the risk of a credit union it should use its other supervisory methods to influence change.*

Conclusion:

As described above, FFCU believes there are several issues that need to be addressed and adjusted in the proposed rule as it currently written. Without changing/eliminating many of these described issues, credit unions will be at a disadvantage to other financial institutions which will have a major negative impact on how a credit union serves its membership.

Sincerely,

Dietmar Huesch,
SVP & Chief Financial Officer