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

From: John Pruitt, Financial & Data Analyst
Four Points Federal Credit Union
PO Box 541030
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Re: RIN 3133-AD77

Mr. Poliquin:

I am writing you to address my concerns and provide comment for proposed rule RIN 3133-AD77. This is from myself, and may not reflect the same views held by others at Four Points. In short, I believe that this rule has some merits in bringing capital requirements more in-line with other segments of the financial services industry. This will help in allowing for stronger intra-industry analysis, and consistency in measure potential capital risks. However, I am concerned about several parts of the proposed rule, which I believe may be more detrimental than helpful, or appear to be more of an over-reaction to recent economic and industry-related events.

Before I begin addressing my concerns, I would like to introduce my credit union. Four Points currently serves employees in many agricultural related businesses across the nation, and in fact has members in every state. As an organization, Four Points specializes in Real Estate mortgages, including fixed rate and adjustable rate 1st and 2nd position loans. In total, the mortgage portfolio currently serviced equals 57% of total assets. Four Points also have a diverse investment portfolio, which consists primarily of both negotiable and non-negotiable CDs and mortgage-backed securities.

In reviewing the proposed regulation in both the Federal Register and information presented from NAFCU and 1st Empire, there are several areas of concern. In evaluating these concerns, I have used NCUA's RBNW calculator, NAFCU's RBNW calculator, and analytic information from 1st Empire as well as my own analysis.

Non Risk-Weight related concerns:

According to the Federal Register, the NCUA is looking to address weaknesses in the current net worth ratio and also address other areas of risk, such as credit risk, IRR, concentration risk, liquidity risk, operational risk, and market risk. However, of those, market risk does not seem to belong, as credit unions do not invest in commodities, stocks, or have a significant presence in foreign exchange markets. For the very few credit unions that invest in derivatives, market risk could be a factor; however, this does not appear addressed separately within the proposal. It also does not appear that operational risk is truly addressed either.

Secondly, I do not feel the proposed rule properly addresses IRR, concentration risk, or liquidity risk. I understand that the NCUA is attempted to manage these risks through capital requirements as

the risk weights for longer-term risk assets are harsher; however, this does not translate to proper risk management. IRR, concentration risk, and liquidity risk are each unique and complex, but are interconnected. They are best evaluated using an ALM model and governed by robust, detailed policies. Measuring these risks takes many hours of building the model, and involves ever-changing assumptions and calculations. However, it appears this rule attempts to simplify all of this into a ratio. My question with this is why? Do the NCUA's examiners not have the necessary expertise in evaluating ALM models, or do a significant number of credit unions affected by this rule have insufficient models and policies that do not accurately address these risks? I feel all of these risks are best managed through sound policies and a well-tuned ALM model, not a simplified ratio.

In addition, the rule does not address IRR benefits of adjustable rate loans, variable loans, or callable securities, nor does it address liquidity benefits of MBS or negotiable CDs, both of which are fairly easy to liquidate on the open market. Even non-negotiable CDs can be converted with relative ease, albeit with an earnings penalty. It also does not evaluate access to secondary and emergency capital, such as access to the CLF, Fed Discount Window, or the NCUSIF deposit. Without accounting for these (admittedly this could be difficult), I do not believe it is realistic or prudent to try to account for such complex risks through a simple ratio. I believe even current ratios fail to truly demonstrate how such risk is managed. These are already managed through policy and modeling and should remain so. The FDIC limited its focus to credit risk, and left the IRR, concentration risk, and liquidity risk to the institution to manage within the confines of their analytical models and policies, and I feel the NCUA should do the same.

Thirdly, I do not feel it makes sense to remove the NCUSIF deposit from both the numerator and the denominator of the proposed RBNW rule. This has a profound impact on the ratio, as this line item accounts for approximately 1% of shares. On Four Point's RBNW calculation, this lowers Four Point's current RBNW ratio by 1.36% and our projected ratio (5-years from now) down by 0.95%. It would be understandable to remove the NCUSIF deposit from the denominator; however, my understanding is that the NCUSIF deposit is a secondary, emergency capital source should it be absolutely necessary due to extreme reductions in capital. Given that credit unions cannot raise capital except through earnings, removal of this forces credit unions to hold significantly more capital. I feel that given how the rule is to combine both the net worth requirement of 7% and the RBNW of 10.5%, the removal of the NCUSIF deposit from the numerator is simply unnecessary, unless the funds deposited into the NCUSIF are completely untouchable in any circumstance, which would be a great concern of another matter.

Fourthly, I have great cause for concern regarding section 104(d) on page 11202. I will say that I fully support requiring institutions to have properly trained staff overseeing asset-backed investments, and the logic behind this rule is sound. However, I do not agree with an examiner's ability to significantly increase related risk weights upon their discretion of a credit union's demonstration of understanding. This seems more of a management concern than a risk concern, and should be addressed through other channels already in place, such as a DOR if the examiner feels the lack of competency in asset-backed investments could generate significant risk, or even a cease and desist if it is believed there is absolutely no understanding or restraint among management to oversee such investments. There are already methods to manage this type of managerial risk, and this new authority to examiners seems arbitrary.

Finally, in regards to non-risk weight concerns, the proposed rules allowing the NCUA board to impose higher capital requirements upon any credit union at their discretion seems very much like

an attempt to have the authority to "manage" a credit union beyond regulatory oversight. I fear that if the NCUA does obtain this authority, it will generate a much higher level of risk-aversion than is already present. That may or may not be the NCUA's intent, even though the credit union industry is already among the most risk-averse in the world. Too much risk-aversion will significantly affect CUs ability to serve members and generate higher ROA. If the NCUA can change the rules on a CU at their discretion, it will generate uncertainty in the industry, which further raises risk-aversion and hurts services and earnings. There has to be balance between regulatory oversight and CUs ability to manage themselves, and this provision provides too much power to the NCUA.

Risk-Weight related concerns:

Having experience and education in finance and economics tells me that there is not a "perfect" model for complex data. It also tells me that the more variables one tries to control in a model, the likelihood for the model to demonstrate a lower correlation increases. While there are exceptions to the rule, I believe that trying to successfully moderate six (remove market risk and operational risk, four) areas of risk with varying degrees of complexity within a single ratio is a significant challenge, and part of my concern is that if the NCUA tries to manage everything well through the use of this ratio, regardless of current requirements for these risks, it will find itself deceived of the seriousness of more complex issues relating to these risks that would not be apparent through ratio analysis. I feel this would only be acerbated given some of the risk-weights proposed.

The FDIC weights attempt to provide generalized average risk weights for different asset and capital categories, and appear to focus more on credit risks. However, the NCUA's proposal includes higher risk-weights in all but one major category, likely due to its attempt to manage aforementioned risks. The NCUA is required to maintain PCA and capital requirements comparable to the banking industry, and this proposed rule is a step in that direction, although I feel it is an overstep to over-correct based upon recent financial and economic situations affecting credit unions. I will address each risk weight below:

Category	Sub-Category	NCUA proposal	FDIC weights	Notes/Comments
Equity		1	1	No comment
Contra Assets		1	1	It is good that ALL is included in the capital
Other Assets	Goodwill	-1	-1	It is understandable these are removed. However, it may reduce willing merger partners due to additional capital concerns.
	Identifiable intangible assets	-1	-1	
	NCUSIF	-1		Removing this from the numerator does not make sense. This deposit is a "last line of defense" source of capital to mitigate extreme losses of capital. I have previously addressed this in this letter.
Cash		0	0	No comment.
Investments	0-1 Year	0.2	0.2	Comparable to FDIC. Weight would indicate this is a "low risk" asset.

	1-3 Years	0.5	0.2	Not sure why a 13-36 month CD would have 2.5 times the risk of a 12 month CD. Insured or guaranteed investments have no credit risk, but these are considered just as risky as 10-30 year mortgages (<25% of assets) on the books. In addition, how is it possible that a 5-10 year MBS or insured CD have twice the risk of consumer loans, and have a higher weight than delinquent RE loans? I understand the attempts to mitigate IRR and concentration risk, but these rules completely ignore margin management and prudent investment strategies, which vary significantly due to changes in rate environments. If rates were to increase back to 7-8% prime levels, would the NCUA change these rates to indicate that longer-term investments are better? Please don't try to manage to the economic environment of today. If the NCUA feels that greater risk weights are necessary, please provide statistical and financial proof that these weights are prudent and necessary. Otherwise, they feel highly arbitrary and I feel they do not appropriately address the risks, especially if the risks are well-managed. I feel these weights should be consistent with FDIC weights.
	3-5 Years	0.75	0.2	
	5-10 Years	1.5	0.2	
	>10 Years	2	0.2	
	Corporate CU Member Capital	1		Assigning high risk-weights to investments with corporate credit unions will likely deter credit unions from investing in these entities. I suggest a more investor-friendly weight, between 0.2 and 0.5. If the current rules for PIC warrant such rating, consider adjusting those rules as well.
	Corporate Paid-in Capital	2		
Real Estate Loans	**Non-delinquent 1st mort R/E loans**			
	<25% of assets	0.5	0.5	Credit unions such as Four Points that specialize in mortgage lending may be forced to sell loans due to increased capital requirements. There is increased credit and concentration risks with these, and weighting these a 2.5 times investments (assuming investments at 0.2) seems reasonable. Indicating that mortgage balances >35% of assets are twice as risky as those <25% of assets, and twice as risky at weights proposed by the FDIC needs mathematical clarification.
	25-35% of Assets	0.75	0.5	
	>35% of Assets	1	0.5	

	Other R/E and delinquent R/E			
	<10% of Assets	1	1	No comment.
	10-20% of Assets	1.25	1	Again, same position as other mortgage loans. Where is the analysis that indicates that these concentrations are more risky, and warrant higher weights than FDIC?
	>20% of Assets	1.5	1	
Other Loans	Non-delinquent student loans	1	1	No comment.
	Non-delinquent other loans	0.75	1	Only major category lower than FDIC. This makes sense, as CU delinquency rates in this category are much lower than those at banks.
	Delinquent other loans	1.5	1.5	No comment.
	SBA	-0.8	-0.8	Has the NCUA ever tried to get their money back on a SBA guaranteed loan gone bad? Why does this not address any other risks in its weight? This is one I believe should be higher, at least 0, prefer 0.2.
	MBLs			
	<15% of Assets	1	1	
	15-25% of Assets	1.5	1	Again, same position as with mortgages and investments. Some CUs specialize in MBLs, and CUs are required to have expertise for these. Please explain logic behind the increased weights.
	>25% of Assets	2	1	
Other Assets	Goodwill	-1	-1	No comment.
	Identifiable intangible assets	-1	-1	
	NCUSIF	-1		Not detrimental to remove from denominator.
	Inv't in CUSO	2.5		Do not know enough information to comment. What analysis has the NCUA completed to assign this weight?
	Mort servicing rights	2.5	2.5	I do not believe this should be rated so highly, but I know it is a very small part of the balance sheet. Not of major concern.
	All other assets	1	1	No comment.
Off Bal Sheet	Loans with recourse	0.75		There should be some weight to these; however, even though there is recourse in relation to credit risk, other risk areas are not applicable, so having the same weight as consumer loans, and a higher weight than most 1st mortgages seems a bit high. I think a weight of 0.5 would be more appropriate.
	Unfunded commitments bus loans (75% conversion)	1	1	No comment.
	Unfunded commitments non-bus loans (10%conversion)	0.75	1	No comment.

Overall, I feel the risk weights have been overly elevated far above comparable FDIC measures, but without financial or statistical data to support the decisions. In addition, as I have previously addressed, it does not consider that the majority of risks this ratio attempts to manage are very complex, and the risk weighting, while it must be done, seems to overly punish certain financial structures, such as those heavy in mortgages and those with a well-laddered and diversified investment portfolio. The difference in weights appear directly related to NCUA's attempts to mitigate additional risks in IRR, concentration risk, and liquidity risk. However, many weights simply do not make much sense in relation to others, and others seem a bit arbitrary.

I would very much like to see how these weights were derived. Based on my observations, the NCUA may be using such failures as in Telesis CU as a basis for these weights. There is some prudence to using past failures to better tomorrow. However, while it is understandable, the vast majority of credit unions that fail are very small, and are little threat to the NCUSIF. According to the Financial Stability Oversight Council's report to Congress in June 2012:

- A primary driver of Corporate CU failures was private-label MBS investments
- Poor management was leading cause in 85 natural person CU's failure
- PCA in general is weak due to reliance on capital
- The NCUA is committed to a review of PCA regulations
- NCUA would continue to research methods of early problem detection

I feel this report was the lead-in to the current proposed regulation. While I do applaud NCUA's move to update PCA and RBNW regulations, I do not feel this proposal truly addresses NCUA's goal of early problem detection, and overly simplifies the measurements of all involved risks. It can also be ascertained from this report that primary causes of these failures fall outside of the scope of the proposal, private uninsured investments and poor management. I personally believe that there are much more important managerial risks to be concerned about, such as the retirement of CU executives without successors, and how ROA for CUs in Peer group 2 is a -0.06%, and the ROA for CUs in Peer group 1 is -0.57%, but there are 2200 credit unions in these groups, about 31% of all CUs. I am glad this regulation does not apply to them.

Summary:

In general, I like the direction of this proposal in helping to build a more consistent capital and PCA requirement to that of the banking industry. However, I have several concerns about this rule. First, I am uncomfortable with the notion that an examiner can, in his or her discretion, change the risk-weighting on asset-backed investments. I agree that CUs should not invest without proper understanding of said instruments, but there are other currently used methods to correct this issue. I also find it very worrisome that the NCUA may establish higher capital requirements to any credit union in their discretion. There are likely legal issues with this, but more importantly, I feel this authority seems more designed to "manage" a credit union that does not fit their comfort level. This may seem to the NCUA a useful tool to manage outliers in risk, but it will generate uncertainty and even higher risk-aversion in the industry. Uncertainty and excessive risk-aversion in an already risk-averse industry will no doubt hinder CUs ability to serve their members and manage to their strengths and specialization. There are already regulations and policies that oversee the involved risks, and both of these proposed authorities seem unnecessary and provide too much power to the

NCUA. It will upset the balance and separation between regulatory oversight and the CU's ability to manage itself.

Several of the risks this proposal tries to mitigate are very complex, and there are already effective and working rules and policies governing these risks. The FDIC took the position that many of these risks are managed by the institution in accordance with the same or similar rules that apply to CUs, and as such they did not include varying weights designed to address those risks. This proposal does not specify exactly how the rule and assigned weights will mitigate these risks, but it appears to be attempting to summarize highly complex risks that are ultimately best analyzed in a comprehensive ALM model, and reviewed by competent examiners who truly understand Asset-Liability Management. If there are other concerns in regards to this, such as the case if either many examiners do not fully understand ALM, or many CUs do not have robust ALM models, then this issue should be addressed separately and openly.

I also believe removal of the NCUSIF deposit from the numerator is a significant detriment to capital calculations, and I believe this will result in a 1-2% RBNW ratio reduction that is not necessary. Given that credit unions cannot raise additional capital; this becomes a significant issue that should be addressed.

In addition, while I understand the desire to better manage many risks with fewer measures, I feel this RBNW calculation, and its assigned weightings, over-simplify the risk measures, and ignore competency and prudency on the behalf of those responsible for those risks. I also believe that it disregards the current effectiveness of policies governing these risks and attempts to substitute a ratio for an ALM model. As such, I do understand the need to generate a capital requirement system similar to the FDIC, and also believe that it is a move in the right direction. However, I believe that if the NCUA is determined to assign higher risk weights than the FDIC (which oversees significantly more assets) to a significant number of categories, then we as those responsible for the financial well-being, and direct oversight and management of those said risks should be provided with ample explanation and supporting data explaining precisely why such weights are necessary. This information has not been provided, and as such it is very difficult to agree to the proposed weights in their current state.

My final note is in regards to the time frame afforded to adopting the rule. 18 months will be a very difficult time frame to modify capital structures of nearly 10% of CUs affected by this rule, and will also be a very short period of time for providers and builders of ALM modeling software to adjust their software to be able to automate the calculation of this ratio. I feel both of these issues warrant a longer period of time before the final rule would go into effect. My recommendation would be to provide at least three years of time after the final rule is published until it takes effect. This will provide a similar period of time to the requirements of the banking industry to adopt most provisions of Basel III.

I sincerely appreciate the opportunity afforded to me to comment on this very important proposed regulation. I hope you find my comments helpful on the matter at hand, and consider my concerns as well as the concerns of many other financial and managerial professionals in the credit union industry and trade.