May 13, 2014

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

Re: Comments on Prompt Corrective Action – Risk Based Capital

Dear Mr. Poliquin:

Suffolk Federal Credit Union appreciates the opportunity to comment on the National Credit Union Administration's ("NCUA") proposed rule "Prompt Corrective Action – Risk Based Capital".

We support the NCUA in their efforts to create a risk based capital framework to ensure the safety and soundness of credit unions. However, we believe the current proposed rule places credit unions at a disadvantage compared to other financial institutions and the rule can be improved. Also, as written, the proposed new regulation will have a negative impact on communities by reducing liquidity for financing for families and small businesses.

Interest Rate Risk

We believe that interest rate risk is best monitored through existing regulations that are reviewed during the NCUA's annual exam at each individual credit union. In our opinion it is better for the risk based capital rule to focus on credit risk similarly to Basel III for banks.

The proposed rule includes a zero risk weighting for US Treasuries regardless of the duration. We agree that there is not a risk of loss since the instrument is backed by the US Government. Since securities issued by the Small Business Administration ("SBAP, SBIC") and the Government National Mortgage Association ("GNMA") have an explicit guarantee by the US Government, we recommend that these securities also receive a zero risk weighting. Under Basel III for banks, these types of securities have a zero risk weighting.

If the goal in instituting higher risk weightings for longer duration securities is to control interest rate risk, we believe there are some inconsistencies with the proposed rule. For example, all US Treasuries having a zero risk weighting regardless of duration. However, all other securities have higher risk weightings for longer durations. We would argue that a 30 year Treasury bill has more interest rate risk than a 15 year mortgage backed security or a floating rate SBA security. Additionally pass through mortgage backed securities pay cash flows throughout their life. These funds can be reinvested. So if we are in a rising rate environment the cash flows can be reinvested up the curve. This is better protection in a rising rate environment compared to a 30 year US Treasury bill.

A second point regarding interest rate risk is the fact that only one asset class has differentiating risk weightings. The weightings are the same for loans regardless of their duration. A credit union that has mostly shorter term consumer loans will have the same risk weighting as a credit union with mostly

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longer term real estate loans. The interest rate risks at these credit unions may be very different depending upon other aspects of their balance sheets. This leads to another point that the duration of liabilities are not even considered under the proposed rule. A credit union with mostly money market and savings accounts (non maturity shares) compared to a credit union with mostly share certificates, may have very different interest rate risks and potential demand. In a rising rate environment a credit union with a high percentage of non maturity shares may be more at risk than a credit union with a high percentage of longer term share certificates.

The proposed rule may have some unintended consequences. In effort to control interest rate risk and require credit unions with longer duration securities to have more capital, it may cause credit unions to lose net income. Some credit unions may be forced to change their investment strategy and hold shorter term investments if they don't have enough capital. This will cause the credit union to record lower net interest income since short term investments yield less. The effect will be lower net income and potentially net losses. Since the only current source of capital for credit unions is retained earnings, this aspect of the proposed rule will make it more difficult for credit unions to accumulate capital and attain higher capital ratios.

Lastly, the proposed rule adds more volatility to the risk based capital ratios. Changes in prepayment speeds can affect the weighted average life of an investment and thus change its weighting under the proposed rule. If there is volatility in the ratios it will make it very difficult to manage the credit union. Changes in prepayment speeds can occur quickly not allowing time for the credit union to manage the portfolio to the capital ratios. This may cause credit unions to only investment in bullet type agencies or Treasuries. These types of securities tend to yield less since there is less optionality. This will cause lower income and less cash flow coming off the investment portfolio compared to pass through mortgage backed securities. Another option for credit unions to avoid volatility in their capital ratios is to increase their loan to share ratio and decrease their investment security portfolio. We are not sure if that was the intention of the proposed rule.

Concentration Risk

While we understand that the higher risk weightings for larger percentage ownership of first lien real estate mortgage loans, other real estate loans and member business loans may be an attempt to control concentration risks, the unintended effect places credit unions at a competitive disadvantage. In order for credit unions to serve their members effectively there is a need to offer financial products for both deposit and loans. Members need the lowest rates for auto loans, consumer loans, first mortgages and home equity loans. If the underwriting standards and credit policies are conservative and sound, material losses can be avoided. We believe our members are better served by offering them real estate loans at competitive prices. The NCUA already completes a comprehensive review during their annual examination on the soundness of the underwriting standards and the compliance with credit policies. Additionally the adherence to concentration policies is already addressed during the NCUA's examination.

The proposed Basel III rule initially included a higher risk weighting for certain types of residential mortgages but after listening to the concerns of community banks across the country, they revised this part of the rule to maintain a 100% risk weighting. Community banks stated that underwriting a first mortgage to a person in the community that they know is not more risky than a commercial loan.

Therefore we believe that there should not be a distinction or higher risk weighting for concentrations in real estate loans or member business loans. The risk weighting should be 100%.

Risk Weightings

We believe there should not be a distinction in risk weightings based on the duration of investment securities. We also have concerns regarding risk weightings for other assets. For example, a delinquent first mortgage loan is proposed to have a risk weighting of 100% and an investment securities with a weighted average life greater than five years is proposed to have a risk weighting of 150%. We would argue that there is more risk of a loss on a delinquent loan than a FNMA mortgage backed security with a weighted average life of six years.

The proposed risk weightings for investments in Credit Union Service Organizations, mortgage servicing rights and investments in perpetual contributed capital seem excessively high and punitive. As an example, the proposed risk weighting for investments in Credit Union Service Organizations is 250% without considering the types of services and investments within the organizations which can vary greatly between credit unions.

Comparison of the Proposed Rule to Basel III for Banks

The NCUA stated that one of the intentions of the proposed rule was to create a risk based capital framework for credit unions that is similar to the regulatory risk based capital measure in Basel III created by the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve and Office of the Comptroller of Currency for banks. However, the proposed rule for credit unions is more conservative than Basel III for banks. This places credit unions at a competitive disadvantage. Not only will credit unions need to have more capital than banks, credit unions are extremely limited on how we can accumulate capital. Currently are only option is through retained earnings. Banks have more options to create capital.
Below is a listing of the specific items that are more conservative than banks under Basel III.

Asset Description	NCUA Proposal	Banks Basel III	Comments
Cash on deposit, including balances on deposit in insured financial institutions and deposits in transit	20%	0%	
Cash equivalents (investments with original maturities of three months or less)	20%	0% - 20%	i.e. GNMA securities have 0% weighting
Securities with a weighted average life of one year or less	20%	0% - 20%	i.e. GNMA securities have 0% weighting
Loans guaranteed 75% or more by SBA, Dept of Agriculture , or other US Gov't agency	20%	0% or 20%	For Banks, 0% for secondary purchase and 20% for originated and held loan
Securities with a weighted average life greater than one year but less than or equal to three years	50%	0% - 20%	i.e. GNMA securities have 0% weighting
Securities with a weighted average life greater than five years but less than or equal to ten years	150%	0% - 20%	i.e. GNMA securities have 0% weighting
Securities with a weighted average life greater than ten years	200%	0% - 20%	i.e. GNMA securities have 0% weighting
Other real estate loans greater than 10% of assets and less than 20% of assets	125%	100%	
Other real estate loans greater than 20% of assets	150%	100%	
MBLs greater than 15% and less than or equal to 25% of assets	150%	100%	
MBLs greater than 25% of assets	200%	100%	

Lastly, the Basel III total risk based capital ratio requirement for banks of 10.5% includes a capital conservation buffer of .25%. In order for banks to have no restrictions on payment of dividends or executive compensation, they must maintain a total risk based capital ratio of 10.5%. Therefore banks can maintain a well capitalized status with total risk based capital of only 10.25%. In order for credit unions to have similar risk based capital requirements, we believe the requirement should be 10.25% for credit unions.

Thank you for the opportunity to comment on the proposed rule for risk based capital. We believe that if a risk based capital framework is adopted then it would only be prudent and fair to provide credit unions with opportunities to supplement their capital beyond accumulating retained earnings. This would allow credit unions to maintain competitiveness in the financial marketplace.

Respectfully submitted,

Sarah McCandless, CPA
Chief Financial Officer
Suffolk Federal Credit Union

cc: William J. O'Brien
President/Chief Executive Officer
Suffolk Federal Credit Union