1st Financial
FEDERAL CREDIT UNION
The Better Way to Bank®

MAY19'14 PM 2:03 BOARD

May 15, 2014

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

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

Dear Mr. Poliquin:

On behalf of 1st Financial Federal Credit Union, please accept these comments on the proposed rule related to Prompt Corrective Action – Risk Based Capital. 1st Financial Federal Credit Union serves the St. Louis metropolitan area, has 33,742 members and approximately $200 million in assets. Overall, we do agree that the industry's net worth ratio needs to reflect the underlying risks of each credit union. However there are several components of the proposal that do not accurately reflect the risk, or lack thereof, for a credit union. They are as follows:

§702.104 Risk-based capital ratio measures

Allowance for Loan and Lease Losses

Limiting the amount included in the numerator for Allowance for Loan and Lease Losses (ALLL) to 1.25% of risk assets should be eliminated. The full amount of the allowance should be included. These funds have been set aside to provide a cushion against losses from charged off loans and reduces the risk to the organization. I presume part of the rationale for the limit is the thought that credit unions could have excess amounts in ALLL. However this should be addressed by the individual review of a credit union's ALLL during an examination (and financial audit) and not part of a blanket reduction of reserves allowable in the ratio calculation. Also, the proposed accounting guidance from the FASB could substantially increase the amount of reserves needed; thereby negatively impacting risk based capital while credit unions work to comply with GAAP.

104(b) Risk-based Capital Ratio Numerator

Our NCUSIF deposit should not be eliminated from the numerator. This deposit is a valid asset. It can be refunded if we voluntarily liquidate. It also provides an additional buffer against NCUSIF losses in addition to our capital if we fail. Furthermore, if we ever converted to a bank charter, it would immediately be included in the numerator.

104(c)(2) Risk-Weights for On-Balance Sheet Assets

Investments

Basing the risk ratings of investments solely on their maturities only takes interest rate risk into consideration. A more meaningful measure would be to use credit risk. Under the current proposal, a fully insured 5 year CD would have a 150% risk weighting, while a private label mortgaged backed security with a remaining life of less than 3 years would have a risk weighting of 50%.

Also, consider that a 1st lien mortgage loan originated by a credit union could have a risk weighting as low as 50%. That same mortgage loan could be sold to FNMA, securitized, and re-purchased by the same credit union (with payment guarantees from FNMA) and it would have a 150% risk weighting. Our recommendation is that the risk weightings based on credit risk utilized by the banking industry be used for credit union investments. These weightings are more reflective of the credit risks inherent in the investments.

Investments in CUSOs

Weighting investments in CUSOs at 250% is excessive and arbitrary. Many smaller credit unions have investments in and rely on large, well-capitalized and well managed CUSOs to provide essential services such as card processing services. This weighting percentage does not accurately reflect the risk for all CUSOs. Consideration should be given to the financial performance of the individual CUSO as well as the risks that exist within their respective balance sheets.

Section 747.2006 Review of Order Imposing Individual Minimum Capital Requirements

Giving an NCUA Examiner the ability to set minimum capital thresholds at their discretion provides the examiner with too much latitude which will lead to inconsistent interpretation and application of the ruling. If the proposed ruling adequately reflects portfolio risk and all of the terms in the proposal are properly explained, there should be no need for an individual examiner to set a higher Risk Based Capital threshold.

Supplementary: Section III Effective Date

The timeline for adoption of a finalized rule should be extended. It would take several years to plan for and implement a strategy to re-position a credit union's balance sheet to successfully be able to achieve the significant amount of capital required to meet the stringent requirements in the proposed legislation. When Basel III went into effect, banks were given nine years to comply. Eighteen months is much too short of a timeframe.

Thank you for the opportunity to comment on this proposed rule and for considering our view on the risk based capital requirements.

Sincerely,

Carol Minges

Chief Executive Officer

May 14, 2014

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

MAY19'14 PM 2:01 BOARD

Re: RIN 3133-AD77 Comments on Proposed Rule: PCA— Risk-Based Capital

As a member of the Supervisory Committee of Affinity Federal Credit Union, I would like to take a moment to comment on the February 2014 National Credit Union Administration (NCUA) proposed risk based capital rule. I appreciate the opportunity to express my thoughts on this far reaching regulatory proposal and to express some of my concerns about the potential negative impact of the proposed rule on credit unions if finalized in its current form. I would also like to offer some suggested improvements in the rule for your consideration as you move forward in the rulemaking process.

Affinity is a $2.3 billion credit union with 134,000 plus members and was chartered in 1935 to serve members' financial needs. I view this current proposal from NCUA to be a redirection of that charter away from its members. If approved as currently written, NCUA's proposed Risked Based Capital regulation will drive a culture of risk avoidance and a focus on capital accumulation rather than on serving the financial needs of our members.

Risk is a part of everyone's lives and must be managed, not avoided. Capital must be accumulated by serving members while managing the risk that is inherent in providing that service, yet member service is always first and foremost. We have just gone through the most significant financial crisis the world has ever seen and natural person credit unions, individually and collectively, had more than adequate levels of capital based on the current statutory levels established by Congress. Not only did they have capital, but they built capital during the crisis. In other words, there is absolutely no logical reason to require the significantly higher amounts of capital being proposed. Our concerns include but are not limited to the points noted below.

Individual Minimum Capital Ratio (IMCR): The biggest and most dangerous proposal is the IMCR. It is totally subjective authority given to examiners and it overrides all risk weighting or leverage ratio outcomes. This part of the rule must be totally stricken and never allowed in any regulatory environment.

Inconsistency with bank calculation of Risk Weighted Assets (RWA): The proposed rule attempts to incorporate multiple types of financial risk exposures into one set of metrics. One of NCUA's goals is to have PCA metrics that address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk." Neither Basel III nor the FDIC Interim Final Rule attempts to capture interest rate risk, liquidity risk, market risk, or operational risk in its risk weightings. The bank rules address credit risk in the PCA metrics. FDIC acknowledges that risk exposures and factors other than credit risk may call for an institution to increase its capital levels but employs supervisory assessments, rather than PCA risk weightings, to tailor an individual institution's required capital to its risk profile. NCUA's approach puts credit unions at a distinct disadvantage to community bank competitors.

Concentration Risk multipliers for real estate and member business loans: NCUA requires increasing risk weights for concentrations in real estate and member business loans. Risk weights increase as the % of assets in these loan categories increase. Credit unions would require 2x the capital relative to bank competitors for each $ of current 1st mortgage exposure over 35% of assets if the concentration risk multipliers for real estate loans are not modified. Concentration above

20% of assets for other real estate exposures above 20% of assets results in 150% of what is required under bank rules.

Interest Rate Risk multipliers for investments: *NCUA incorporates interest rate risk multipliers into the investment portfolio. Risk weights for investments increase as a function of weighted average life of the investment. NCUA would risk weight our investment portfolio at 5X what the bank model suggests as the bank model does not include interest rate risk in the calculation of risk weighted assets. Interest rate risk is adequately addressed in NCUA's interest rate risk regulation and is amply analyzed in the supervisory exam. Furthermore, including interest rate in PCR requirements without including the offsetting liability metric is not sound.*

Impact on credit availability & competitive disadvantage: *Including interest rate risk multipliers for the investment portfolio and concentration risk multipliers for mortgages and member business loans is contrary to the other federal regulator's PCA rules. The concentration risk multipliers on mortgages and member business loans will not only limit supply of these loans but will also impact pricing of loans to members. If banks have a lower capital requirement, they can price differently. Should NCUA be an arbiter in influencing the market's pricing for critical sectors such as mortgages and small business loans? Should NCUA propose rules that will cause credit unions to lose market share and impede their ability to grow and grow capital?*

Impedes ability to build capital: *The proposed rule creates a bias in favor of consumer loans. It is clear that NCUA prefers assets that are short term and is partial to retail unsecured exposures. This, along with the severe investment portfolio risk weights, will force credit unions down the yield curve to short duration assets and impede the ability to build capital. This overly prescriptive and onerous regulation essentially dictates the credit union's balance sheet structure and minimizes the board and management's ability to take calculated risk on behalf of members or structure an investment portfolio that balances risk and return. That is not the job of a regulator.*

CUSOs: *The risk weight applicable to CUSOs is flawed. Not only is the 250% too high but NCUA double counts exposure for majority owned CUSOs. Majority owned CUSOs are accounted under the consolidation method of accounting. RBC is based on a CU's consolidated balance sheet and thus, the assets for majority owned CUSOs are already risk weighted. Adding capital based on a schedule that shows unconsolidated results is double counting. In addition, it is contrary to the credit union's DNA-cooperative efforts to serve members and enhance the industry.*

Strategic Plan: *Under community bank guidelines Affinity has a substantial cushion above both the leverage and risk based capital ratio requirements that qualify an institution as "well-capitalized". Maintaining a cushion above well capitalized is a priority for Affinity's board of directors. Under NCUA's proposal, the credit union would fall to adequately capitalized for the risk based metric and remain well-capitalized under the leverage/Net-Worth measure. This proposal could result in a modification of our strategic plan and impede our ability to invest in and grow the business in order to serve members today and over the long run.*

Numerator: *Deducting the NCUSIF from capital assumes that this asset is essentially worthless. Treating this asset as impaired is contrary to GAAP and irrational given that its value is continually preserved through assessments.*

The simple solution to all of the problems of this new proposal is to adopt the BASEL III/Community Bank model and completely remove the examiner discretion provision.

One final suggestion is to allow all natural person credit unions to access secondary or supplemental capital. Capital access is a more constructive approach to achieving capital objectives than actions such as driving out deposits, shrinking assets, curtailing lending or reducing investments in the people, systems, marketing and branching required to win business, secure technology and serve members.

Thank you very much for the opportunity to comment on this proposed regulation. While I support the efforts of NCUA to pursue a balanced risk-based capital system, the proposal in its current form is overzealous and results in undermining the value of the credit union charter. I respectfully encourage NCUA to consider some of the recommended improvements to the proposal contained herein. With the right changes, this rule can become a source of long term viability of the credit union charter. If I can be a source of any further information on this comment letter, please do not hesitate to contact me.

Kind regards,

Nicole Pullis

Nicole Pullis
Supervisory Committee
Affinity Federal Credit Union

cc: The Honorable Frank A. LoBiondo, US House of Representatives
The Honorable Jon Runyan, US House of Representatives
The Honorable Chris Smith, US House of Representatives
The Honorable Scott Garrett, US House of Representatives
The Honorable Frank Pallone, Jr., US House of Representatives
The Honorable Leonard Lance, US House of Representatives
The Honorable Albio Sires, US House of Representatives
The Honorable Bill Pascrell, US House of Representatives
The Honorable Donald Payne, Jr., US House of Representatives
The Honorable Rodney P. Frelinghuysen, US House of Representatives
The Honorable Rush Holt, US House of Representatives
The Honorable Robert Menendez, United States Senate
The Honorable Cory A. Booker, United States Senate
Ms. Deborah Matz, NCUA Chairman
Mr. Michael Fryzel, NCUA Board Member
Mr. Richard Metsger, NCUA Board Member