Arkansas Federal
CREDIT UNION
Improving Each Member's Financial Life

May 19, 2014

Gerard Poliquin, Secretary of the Board
Via email: regcomments@ncua.gov
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Mr. Poliquin,

On behalf of Arkansas Federal Credit Union in Little Rock, Arkansas, I would like to offer the following comment letter on the recent NCUA proposed Risk Based Capital (RBC) rule. We recognize the need for capital reform as the changing landscape of credit union risk profiles is not completely captured within the current 7% calculation. However, we do implore the agency to carefully consider the implications of this regulation. As an industry, it is essential to have adequate capital to ensure long term survival, but we also must be aware of the consequences set forth in regulations could ultimately have on the consumer. For our credit union, although this regulation does not hinder our growth plans today, it could in the future. The chart below shows our capital in relation to regulatory minimum and proposed RBC. You will notice we are 135% of the 7% minimum and 129% of the 10.5% minimum. We do not have plans to drive our capital to those levels, but the 6% difference or changes in balance sheet structure could impact us in the future.

3/31/2014	Actual	Regulatory Minimum	AFCU % of Minimum
Net Worth Ratio	9.48%	7%	135.43%
Risk Based Capital Ratio	13.59%	10.50%	129.43%

The RBC proposal is very similar to Basel III but with some distinct, slight differences. Below I have outlined several differences that we note as potential concerns. We are advocating to use the same standards that govern banks, but if we so choose to be slightly different, let's improve the risk standards.

	RBC	Basel III Banks <15B	
Loans			
First Mortgage 25% - 35% of Total Assets	75%	50%	
First Mortgage >35% of Total Assets	100%	50%	
Other Real Estate 10% - 20%	125%	100%	
Other Real Estate >20%	150%	100%	
MBL 15% - 25% of Assets	150%	100%	
MBL >25% of Assets	200%	100%	
Consumer Loans	75%	100%	
Investments			
>1 to 3 Years	50%	20%	*Depends on Type could be as high as 100%
>3 to 5 Years	75%	20%	*Depends on Type could be as high as 100%
>5 to 10 Years	1.50%	20%	*Depends on Type could be as high as 100%
>10 Years	2.00%	20%	*Depends on Type could be as high as 100%

P.O. Box 9, Jacksonville, AR 72078-0009 Phone: 501-982-1000 Fax: 501-982-3299 AFCU.org

Loans

The weighting in the numerator of this ratio specific to the asset portion of the balance sheet appears to try to capture both credit risk and interest rate risk. Although, these weightings may be representative of risks on a national level, they are not indicative of individual credit union balance sheets. For example, does having more than 35% of credit unions assets in first mortgage loans always mean there is more interest rate or credit risk? There are call report fields that would capture the interest rate risk portion of this. In the case of other real estate, the RBC rule puts substantial more weighting on this asset than even a traditional consumer loan. If a credit union is offering low LTV second loans does it really garner more risk than a consumer loan that is given a weight of 75%? Same point on MBL.

I can completely agree with the approach, but I think some quantification of a credit union's current delinquency or loss ratios should be incorporated into these weights. This would more closely align risk with prior losses. The rule already allows for examiner judgment, and if, during the process of an examination, an examiner noted substantial changes that are not reflected in the weighting, they could administratively increase the regulatory minimum RBC.

I understand the agency's position on real estate and member business loans as those assets caused substantial losses during the last crisis. The challenge is when risk weights are increased it could inhibit the earnings power which could reduce equity growth over time to prevent another crisis.

Investments

Most credit unions purchase investments that are agency-backed so I will utilize that as my baseline for comparison. Basel III would utilize a 20% risk weight for these types of investments regardless of maturity; RBC rules vary from 50%-200% for investments with maturities >1 year. A credit union wishing to extend the duration of their assets may portfolio a similar maturity first mortgage (or MBL) in lieu of purchasing an investment if looking in the > 5year or >10 year bucket and did not have large concentrations in MBL or Real Estate. Those assets are likely to be less liquid in the future than the agency investment that might have otherwise been purchased. Point is there are unintended consequences that may result from defining the box for credit unions to operate.

Liabilities, Shares and Derivatives

As the goal of the RBC rule is to better reduce major risks within the industry, I propose a system of incorporating strategic decisions made by credit unions into the analysis regarding interest rate risk. An argument could be made to offset interest rate risk from first mortgages with longer term shares or borrowings. Also, the recently approved derivatives could be utilized as a hedge. Information on these items is already captured in the 5300 report and could be utilized to offset the longer term assets that potentially receive a higher risk weight.

We appreciate all of the hard work put in to provide the appropriate capital frame work for the future of the credit union system. We look forward to the final rule and will structure our balance sheet accordingly to ensure compliance by the stipulated implementation date.

Sincerely,

Walter L. Biernacki, Jr.
President/CEO