FEDERAL CREDIT UNION
Better Banking.

May 22, 2014

Mr. Gerald Poliquin
Secretary to the NCUA Board
1775 Duke St.
Alexandria, VA 22314

By Electronic Mail

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

Dear Mr. Poliquin:

Thank you and the NCUA Board of Directors for the opportunity to comment on the proposed risk-based capital rule (the "proposed rule"). The Board of Directors and management of GFA Federal Credit Union ("GFA") believe that the closer alignment of capital regulations of banks and credit unions is a positive step in creating more of a "level playing field" in the universe of financial institutions. While we see the proposed rule as a positive step, there are aspects of the rule that we would like to comment on.

GENERAL:

The proposed rule appears to be somewhat parallel to the Basel III Accord for banks. The purpose of the risk-based capital guidelines from the Basel accords was to risk-weight banks' assets based on default risk. NCUA's proposed rule attempts to take a "one size fits all" approach to managing multiple risks relative to capital; where managing certain risks, for example, interest rate risk, are already addressed in other regulatory guidance, making some risk-weights assigned to assets a redundant regulatory measure that will restrict the profitable growth of credit unions, and create a further competitive disadvantage when compared to banks.

INVESTMENTS:

The proposed rule utilizes differing risk weights to compensate for interest rate risk, based on the final maturity or average lives of the investment, from 20% for investments with lives of 0-1 year to 200% for an investment with a life over 10 years. When comparing the proposed rule to risk-based capital regulations for the FDIC, the FDIC does not take interest rate risk into consideration at all. The proposed rule, as written does not take into account any risk-mitigation efforts; for example, adjustable rate assets or derivatives, nor does it consider de facto risk mitigation that may be inherent in a credit union's balance sheet from the lives of certificate accounts or the long-term nature of a credit union's core shares.

Credit unions already monitor and control interest rate risk through internal policies and in accordance with NCUA Rules and Regulations, supported by the ongoing examination process. The layering of risk-weights for different average lives is an unnecessary redundancy in regulation, and is restrictive to credit unions that rely on an investment portfolio for earnings as well as for a liquidity warehouse. The appropriate risk-weighting remains at the 20% for credit union investments in government agency-backed securities, with a 50% risk weight for municipal bonds whose source of repayment is revenue from a project (revenue bonds).

The risk-weights as structured also create a bias against investments, in favor of loans. In example, a 30-year mortgage with an assumed 7-year average life carries a risk weight of 50%-100%, while an agency insured mortgage-backed security with the same characteristics carries a risk weight of 150%, while carrying less credit risk. This disparity discourages credit unions which have a low loans-to-assets ratio from safely and profitably investing in assets that resemble loans to maintain an income stream.

As currently drafted, the proposed rule would alter GFA's strategy of carrying high-quality mortgage-backed securities to support profitability, given our approximate 50% loans-to-assets ratio; instead considering riskier participations in mortgage loans which would carry a similar level of interest rate risk, as well as more credit risk. Ironically, the investment vehicle that carries more overall risk, mortgage loan participations, carries a lower risk weighting (maximum 75% if the participations are not delinquent, versus a maximum of 200% for a 10-year average life mortgage-backed investment). The investment alternative available to GFA that will maintain our net interest margin would be the purchase of a 30-year U. S. Treasury Bond, which carries a 0% risk weight, yet carries more interest rate risk than the mortgage-backed investment which could carry up to a 200% risk-weight. The greater point is that credit unions nationwide will be altering their investment strategies to manage their risk-based capital ratios; which will result in more true risk, or lesser profitability.

NON-DELINQUENT FIRST MORTGAGE LOANS

The purpose of the three-tiered structure of the risk-weights in first mortgage loans appears to be to compensate for concentration risk, as the risk weight increases from 50% to 75% as first mortgage loans increase to a level greater than 25% of total assets and to 100% as the first mortgage loans increase above 35% of total assets. The FDIC currently risk-weights these assets at 50%.

As with interest rate risk, concentration risk is managed and monitored through internal policies, guided by NCUA Rules and Regulations, and supported by regular examinations. Utilizing different risk weights again creates a regulatory redundancy and will further restrict mortgage lending as a credit union product. In a national economy that needs lenders to create new homeowners as economic stimulus, one can hardly afford to further restrict home lending, making credit unions a smaller player in the mortgage business, and forcing our members to resort to banks and mortgage companies who favor profits over protection of our members. Additionally, there is no more inherent risk in the mortgage loan that takes a credit union to a ratio of 25.1% of total assets than the loan that took the credit union to 24%, so an increase in the risk-weight is not necessary.

Given the adoption of the proposed rule, GFA would have to consider altering its decision to originate first mortgage loans, in favor of investments, or consider selling a greater level of mortgage loans in the secondary market; an activity that, coincidentally, would be limited by the 250% risk weight on mortgage servicing assets.

CUSOs

The proposed rule provides for a 250% risk weight for an investment in a CUSO, as compared to a 100% risk weight for a loan to the CUSO. This disparity will discourage credit unions from investing in organizations that support the collaborative nature of the credit union industry, and encourage lending to those organizations. The failure of a CUSO would undoubtedly result in loan default as well as capital erosion, so a differing risk-weight seems unnecessary. Regardless of whether it is a loan or investment made to a CUSO, in the event of a CUSO default, the credit union loses their investment or the loan so there is no apparent reason for the differential in risk rating. The 100% risk weight for loans more accurately reflects the risk inherent in capital investments in a CUSO.

Recent regulatory changes create greater examination scrutiny for CUSOs, and that examination support should be adequate to monitor and control the risk from CUSO's. Additionally, investments in CUSO's represent 0.22% of credit union assets nationwide, which does not represent a systemic risk to the insurance fund, so greater risk weighting is not warranted.

GOODWILL AND NCUSIF

The proposed rule removes goodwill from the numerator and denominator of the risk-based capital calculation, effectively reducing the risk-based capital ratio for these assets. Goodwill is present on the balance sheet as a result of credit union mergers. The rule discourages mergers by penalizing the acquiring credit union for the merger by reducing its calculated risk-based capital ratio. This action discourages mergers that protect the insurance fund by merging an unhealthy credit union into a healthy one, rather than liquidating the unhealthy credit union; ultimately placing the insurance fund at greater risk. It also punishes credit unions that have executed mergers in the past, when goodwill was not considered in the capital ratio calculation.

GFA would have to consider goodwill implications should it enter into any future merger discussions, and may be discouraged from mergers because of risk-based capital considerations.

The proposed rule also removes the NCUSIF deposit from capital and assets as part of the risk-based capital calculation, effectively considering this asset, accumulated over years of credit union growth, an expense for risk-based capital purposes. This calls into question whether this deposit is actually an asset at all, and contravenes the current regulatory accounting practice that records this as an asset. The resultant reduction in the risk-based capital ratio limits growth potential of credit unions nationwide, and potentially limits the ability of a credit union to support its membership by limiting that growth.

INDIVIDUAL MINIMUM CAPITAL REQUIREMENT

The rule provides the NCUA the ability to impose a higher risk-based capital ratio requirement on an individual credit union NCUA determines that circumstances indicate a higher risk-based capital requirement is appropriate. This creates a level of subjectivity to the calculation. Since it is unlikely that the NCUA Board itself will be examining the credit union they will be imposing the higher requirement on, the recommendation will come from examiners, based on their opinion that the credit union is taking excess risk, without any defined quantitative support for said opinion. Since the circumstances under which a higher risk-based capital requirement are not defined, that subjectivity gives an examiner absolute power to impose a "supervisory assessment". Lacking a quantifiable standard to impose the "supervisory assessment", the examiner can recommend such an assessment at any time, for any reason. We acknowledge the proposal of an appeals process; however, this seems counter to the fact that it will be the NCUA Board that will allow for the risk weight adjustment in the first place.

This subjectivity undermines the very purpose of the proposed rule; as on one hand the rule is factoring in a number of risks, but if the NCUA Board decides that the standard is not working for a credit union, then the Board can simply change the rule. The appeals process places the burden of proof on the credit union to prove to the body that enacted the higher requirement that is was wrong; and the Board is not bound by any recommendation made by the NCUA Ombudsman. The appeals process needs to be independent of the NCUA Board.

Further, the significant increase in the risk weighting based in part on the subjectivity of an examiner, is exorbitant.

The FDIC risk-based capital guidelines contain no such provision. This provision should be removed from the final rule.

TRANSITION RULE

The proposed rule does not carry any transition provision; rather it requires credit unions to comply within 18 months, while increasing the capital requirement from 7% to 10.5%. This compares to the Basel III changes for banks that carry a 5-year transition to the new standard. It is unreasonable to expect credit unions, which, unlike banks, have no means of raising supplemental capital, to realign balance sheets in order to comply with this rule within such a short time frame.

A five-year transition period is appropriate for such a monumental regulatory change, and should be provided for in the final rule.

GFA also suggests, that given the sweeping nature of this capital management rule, and the stringent risk-weights having the potential of restricting growth, that the NCUA Board consider allowing all credit unions the opportunity to raise limited amounts of supplemental capital, to allow credit unions the ability to remain "well capitalized" and allow further growth, which ultimately supports both credit union capital and the national economy.

CONCLUSION

The proposed rule, as drafted, creates new obstacles for well-run credit unions' continued success. Overly restrictive risk weights for several asset categories, elimination of goodwill and the NCUSIF deposit, the lack of a transition rule and subjectivity all make this rule burdensome By modifying risk-weights, reinstating goodwill and the NCUSIF deposit, eliminating subjectivity and providing for transition and supplemental capital, co that credit unions can more easily meet the requirements of the proposed rule, a successful risk-based capital model can be put into place.

An effective risk-based capital program should provide assurance that capital is commensurate with the risks taken by an individual credit union. But it cannot be a panacea to eliminate nor can it manage all risks.

There is a time and place for everything and while we respect the need for capital reform, these onerous changes are proposed with stringent implementation times, at a time when margins continue to shrink. A credit union needs to grow if it is to remain a viable financial institution. The proposed risk weight capital plan limits a credit union's ability to grow and provides for no additional methods to contribute to capital other than through retained earnings. We need to examine this proposed rule in totality if we are to provide for a safe AND effective, relevant industry.

Thank you again for the opportunity to comment and we hope that consideration is given to the concerns expressed.

Very truly yours,

David C. Bojarczuk

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Director of Corporate Finance
Chief Financial Officer