Financial Partners CREDIT UNION
7800 East Imperial Highway • Downey, CA 90242 • P.O. Box 7005 • Downey,CA 90241-7005
800.950.7328 • Direct Line 562.923.0311 • Fax 562.904.4285 • www.fpcu.org

May 22, 2014

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

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

Dear Mr. Poliquin:

Financial Partners Credit Union (FPCU) appreciates the opportunity to comment on the National Credit Union Administration (NCUA) Board's proposal to revise Prompt Corrective Action related to Risk-Based Capital. FPCU is a community based organization with $890 million in assets and serves 62,000 members. While FPCU agrees with the effort to fine tune capital standards to shore up credit union balance sheets, we believes the current Proposed Rule will have a detrimental effect on both our members and the long term strategic position of the credit unions. FPCU is asking the NCUA to consider revising risk weightings to more reasonably align with well capitalized requirements to US banks and other financial institutions in the world governed by the Basel III framework. Under the proposed risk-based capital rule, FPCU will see its well-capitalized buffer fall by 31%, from $23 million to $16 million. The credit union may be forced to change its business model as it relates to lending, long term investments that may adversely impact member services, disadvantaging the credit union's position relative to banks and other competing financial institutions. The Proposed Rule, in its current form will limit the credit union's investments in new branches and new technology.

FPCU is asking the NCUA to consider the following comments in developing the final version of the Risk-Based Capital Rule:

1. A number of the risk weightings under the Proposed Rule appear to be too general or excessive. Under the Proposed Rule, credit union risk weights would be higher than that of banks requiring credit unions to hold more capital than banks for the same assets. This is a major concern to FPCU as it would place credit unions at a competitive pricing disadvantage in an already highly competitive marketplace. In addition, using higher risk weights on long-term assets for interest rate risk mitigation is misleading without appropriate consideration of liability maturities.

    - **Cash Held at the Federal Reserve** - FPCU is holding large amounts of cash at the Federal Reserve as an alternative to short term investments and liquidity consideration. Under the Proposed Rule, cash balances held at the Federal Reserve are assigned a 20% risk weighting. Given that the Federal Reserve is designated as a source for emergency liquidity for the entire credit union industry, there appears to be little risk in holding cash balance at the Federal Reserve. Under Basel III, central bank reserves are deemed to be highly liquid assets during a time of stress and carry a 0% risk weighting. FPCU believes cash balances held at the Federal Reserve should receive a 0% risk weighting in the final version of the Rule.

- **Investments** - Under the Proposed Rule, investment risk weightings for credit unions are significantly higher than that of banks. The NCUA risk weights appear to be punitive and somewhat inconsistent when compared to banks thus putting credit unions at a disadvantage. All Treasury securities and those securities guaranteed by the NCUA or FDIC carry a 0% risk weight, no matter what the maturity. Other Agency backed securities with no credit risk, such as FMNA and FHLMC, are risk weighted based on weighted average life time buckets. Investments with weighted average lives greater than 5 years are given punitive risk weights of 150% for 5 to 10 year average lives and 200% for average lives greater than 10 years. This compares to 20% risk weightings for similar securities in the banking model. In addition, a 30 year whole loan mortgage on FPCU's balance sheet would carry a 50% risk weighting while securitizing the same loan into a 30 year FNMA security, with enhanced liquidity, would carry a 150% risk weighting. FPCU believes to reach appropriate level of parity; the final version of the Rule should more closely mirror bank risk weightings.

- **Real Estate Loans** - Under the Proposed Rule, no distinction is made for the risk weightings assigned to mortgage loans of various maturity and price adjusting terms. A 30 year fixed rate mortgage has the same risk weight as a 1 year adjustable rate mortgage and a fixed rate home equity loan has the same risk weight as a variable rate home equity line of credit. Instead of implementing risk-based capital standards that applies "one size fits all" to the mortgage loans with diverse characteristics and interest risk profiles, there should be a more targeted risk weighting that can more appropriately address this issue. Over the past 5 years, FPCU has been selling the majority of its fixed rate mortgage production and offsetting the held mortgages with long term borrowing positions. As a result of this strategy FPCU's balance sheet is well positioned for a rising rate environment. The mortgages being held in the balance sheet either have short term repricing characteristics or are producing strong, stable principal cash flows that limit exposure to rising interest rates. Under the Proposed Rule, there would be no difference between FPCU's capital requirement for its diverse mortgage portfolio and the capital requirements for a credit union that holds all 30 year mortgages on their balance sheet. FPCU believes that the capital requirement for adjustable rate mortgages and shorter maturity fixed rate mortgage loans should be lowered in the final version of the Rule to fairly take into consideration the reduced risk associated with these adjustable and shorter term mortgage loan products.

- **Member Business Loans** - The NCUA Proposed Rule creates a bias in favor of consumer loans as opposed to other assets such as member business loans. Consumer loans are assigned a 75% risk weighting while member business loans are subject to concentration-based tiered risk weights. FPCU's quarterly profitability reporting shows that the credit union's member business lending portfolio is one of the most profitable product lines on the balance sheet. If the Proposed Rule was to become final, FPCU may opt to increase production in lesser quality indirect and unsecured consumer loans rather than higher quality, more secure member business loans in an effort to preserve its capital. FPCU is urging the NCUA to reconsider and remove portions of the Proposed Rule that apply higher risk weights to member business loans based on a percentage of the credit union's assets in that category.

2. **The NCUSIF deposit** should not be deducted from the risk-based capital numerator. The National Credit Union Share Insurance Fund's 1% deposit is being ignored in the proposed risk-based capital calculation. The NCUSIF deposit is a valid asset that can be refunded for various reasons including conversion to a bank or savings institution charter, electing to transition to private insurance instead of NCUA or voluntary liquidation. In addition, the deposit can specifically be attributable to a failed credit union providing an additional buffer against NCUSIF losses in addition to the failed credit union's capital. If a credit union did convert to a bank charter the NCUSIF deposit would immediately be included in the risk based capital numerator. FPCU recommends exclusion of the NCUSIF deposit from the risk-based capital numerator.

3. FPCU has concerns about the examiner ability to arbitrarily decide if the credit union needs a higher capital ratio, even if the calculation indicates the credit union is well capitalized. The Proposed Rule gives the NCUA authority to require a higher minimum risk-based capital ratio for individual credit unions based on NCUA examiner expertise. This discretion could lead to unfair and inconsistent interpretation and application of the Rule and will lead to mistrust between credit unions and the NCUA. FPCU strongly recommends the elimination of this provision from the final version of the Rule.

4. **Investments in CUSOs** should be risk weighted at 100 percent as opposed to 250% under the Proposed Rule. FPCU has been actively involved with auto lending and operational CUSOs over the years. FPCU's involvement with these CUSOs has increased the credit union's profitability by contributing to increased loan production and by helping to reduce operating expenses. FPCU's exposure is limited to the credit union's investment in each of the CUSOs. The NCUA already limits a credit union's investment in CUSOs, under NCUA Rule 712.4, so it is an overkill to impose a 250% risk weighting on CUSO investments. FPCU is very concerned that the inflated risk weighting on CUSO investments may hinder collaboration among credit unions at a time when such collaboration is vital to the future success of the industry. Many credit unions are looking at CUSO relationships as a way to consolidate functions in an effort to reduce operating expenses and to offset declining net interest income and non interest income levels. FPCU believes CUSO investments should be risk weighted at no more than 100%.

5. **Mortgage servicing rights (MSRs)** should be risk weighted at 100 percent as opposed to 250% under the Proposed Rule. Rising interest rates and the potential negative impact on credit union earnings, is a major concern to the NCUA. FPCU has been selling fixed rate 15, 20 and 30 year mortgage production and retaining servicing to reduce interest rate risk in the balance sheet. The value of FPCU's $560 million servicing portfolio will increase significantly in a rising rate environment as prepayments slow and the average life on the sold mortgages extends. FPCU realizes that MSRs become impaired when interest rates fall

and borrowers refinance or prepay their mortgages. During the last 5 years, in this historically low interest rate environment, FPCU's negative mark-to-market on MSR's was more than offset by increased gains on the sale of mortgages. FPCU believes a 250 percent risk weighting on MSRs is excessive and creates less incentive to build the servicing portfolio, which helps protect the credit union's earnings in a rising rate environment.

6. Consideration should be given to increasing the 1.25% allowance limit for adding to the numerator should FASB adopt the Current Expected Credit Loss model. FASB's proposed new standard on the allowance will most likely increase normal reserves by an estimated 30% to 100% at some credit unions. FPCU believes that more of this required allowance should count towards capital should the higher standard be adopted in the near future.

7. Consideration should be given to permit federally insured credit unions to offer supplemental capital. Credit unions remain the only financial institutions that do not have access to sources of capital beyond their retained earnings. If higher capital standards are to be imposed on the credit union industry under the Proposed Rule, affording credit unions the ability to raise supplementary capital that counts towards net worth requirements seems to be an appropriate policy consideration.

8. NCUA is exceeding their authority -- Congress never intended for NCUA to set up a risk-based capital standard for well-capitalized credit unions. The FCU Act directs NCUA to devise a risk-based requirement, but the risk-based component for the well-capitalized threshold can be no higher than the component for the adequately capitalized level. Under NCUA's proposal, however, that is not what would happen. This goes against the current FCU Act and system of Prompt Corrective Action.

In summary the proposed Rule, in its current form, may reduce the perceived risk to the NCUSIF but at is sure to place real and significant cost on the credit unions and their members. It will place credit unions at a competitive disadvantage, impacting the industry's longevity and over the long run adversely impact all consumers by reducing competition and increasing prices. FPCU believes modifications to the Proposed Rule based on the stated reasons will result a stronger final version of the Risk-Based Capital Rule and in the end result in a stronger credit union industry.

Thank you for the opportunity to comment on the Proposed Rule and for listening to our concerns. Please feel free to contact me with any questions or comments regarding FPCU's comments on the Proposed Rule.

Sincerely,

Mary K Torsney

Mary Torsney
Financial Partners Credit Union
SVP/Chief Financial Officer