May 20, 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:

On behalf of CDC Federal Credit Union, I appreciate the opportunity to comment on the PCA Risk Based Capital Proposed Rule. CDC Federal Credit Union is a $265 million financial institution offering Loans, Deposit Accounts and other financial services to a membership of 18,000 people who are primarily affiliated in some way with the Centers for Disease Control and Prevention or other health services organizations. We have been in existence since March of 1949. Our financial model has been one of providing the membership with low cost lending, market deposit yields and no or low fees to predominantly middle income members. We have chosen a model that sustains a well capitalized credit union (7%+). Your proposal, referred to above, will threaten that model. I would suggest that most credit unions in the USA follow a similar model as ours. You may only hear from a small minority of us in reference to your proposal. If adopted, this proposal will lead to the acceleration in mergers of smaller credit unions into larger ones because of the higher requirement to comply with the new Risk Based Capital calculations which will multiply in the form of software, management, monitoring and much higher audit and examination fees. In order to recover these costs, loan rates must increase, deposit accounts will no longer be free, low cost, or receive competitive market interest rates and services may be eliminated. The American people will lose their local financial cooperative voice and one more option will be closed for many who have few options to begin with. Therefore, we encourage the NCUA to withdraw this proposal.

It is our understanding that the reason for this proposal is to address the collapse that occurred among many financial institutions in 2008 and 2009. We understand the concerns of the agency in the loss of the nation's two largest Corporate credit unions. We believe this proposal is an over-reaction driven by regulator fear of a re-occurrence of 2008 -2009 markets. We believe that steps previously taken by the agency strengthens its ability to manage and monitor credit union's net worth sustainability (i.e. monitoring the Supervisory Interest Rate Risk Threshold (SIRRT)). However, this proposal has been thrust upon us and we feel compelled to respond with the following comments.

Your proposal states that the revisions would require higher minimum levels of risk-based capital for credit unions with concentrations of assets in real estate loans, MBLs or high levels of delinquent loans (page 4, lines 8 & 9). Our credit union does not have a high level of concentration in real estate loans, MBLs or high levels of delinquent loans, yet our classification will be lowered due to a heavy concentration in short term (hard maturity 3-5 years for the entire investment portfolio) of U.S. Government agency bonds (hardly a threat to capital or the National Credit Union Share Insurance Fund). The average life of our entire investment portfolio at April 30, 2014 is 1.7 years. So, how can that, short of basically a guaranteed portfolio (no credit or collateral risk), be 25 points higher than a portfolio of 30 year fixed rate mortgages (which is only 50 points)? This seems inconceivable to me and flies in the

face of the statement, “The design of the RBC~~NW~~ requirement should reflect a reasoned judgment about the actual risks involved.” (page 7, lines 8 & 9)

The proposed rule makes a statement that capital and risk go hand-in-hand and credit union senior management, boards and regulators are all accountable (page 11, lines 6 & 7). The proposal states the purpose for the ruling is to reduce risks to the NCUSIF. While this will be a result of this new ruling, a by-product will be fewer credit unions for the American consumer.

Your proposal indicates that, in general, credit unions have high quality capital. I appreciate that admission and agree with it. Your proposal indicated that the NCUSIF experienced several hundred millions of dollars in losses due to failures of individual credit unions and holding inadequate levels of capital. However, a significant amount of this is due to two Corporate credit union failures. So, it appears your proposal is justifying the raising of capital from a flawed premise that~~:~~ natural person credit unions have the same risk profile as a Corporate credit union, which is not true.

It does appear that the proposal to develop a new risk based capital requirement for complex credit unions has succeeded. If a credit union was not complex prior to the proposal, it certainly will be from attempting to apply the new proposal to its own operations. Your proposal certainly adds complexity with requirements to address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk and market risk. All of which are addressed by well run credit unions in their policies and procedures currently and part of every examination I have personally been involved with at a credit union. Your proposal’s fifth goal has failed. Understanding and implementing programs and projects to address these new requirements will sap the energy of many smaller credit unions and their management teams and will hasten mergers, reducing the number of insured credit unions, requiring less NCUA personnel and fuel the cry for a single regulator (when considering it is so difficult to start a credit union).

CDC Federal Credit Union understands the risks identified in your proposal on page 14. We would like to point out that all of these risks are currently examined, commented on (many times with recommendations) and responded to by the examined credit unions. It is our contention that all of these risks are currently being addressed under the current examination structure and reflected in our current net worth ratio numbers. We acknowledge that the additional risk factors added on pages 14 & 15 (especially off balance sheet items) will negatively affect our credit union. However, in order to ~~we intend to~~ meet this challenge, we would have to change our current business model from low or no cost services to members to members paying more, and us becoming more “bank-like” in our approach to serving members (low cost of funds combined with high loan rates). This will raise our Net Worth and satisfy your new requirements. The credit union will survive, but the members will become worse off. The 2 ½% buffer required above the “8% required by Other Regulatory Agencies” (page 35) arriving at a 10.5% risk-based capital ratio requirement is too aggressive for credit unions. Should the Agency continue to press this, credit unions should receive the same amount of time other regulated financial institutions will receive for implementation of the proposal. That time requirement is 2019 for other regulated financial institutions, why not for credit unions? Eighteen months to change our business model to achieve your numbers is too restrictive.

As we change to manage to your new Capital Adequacy numbers, one strategy we could deploy would be to ~~will~~ implement a plan ~~will be~~ to reduce the size of our Balance Sheet. In other words, we may be forced ~~move~~ to refuse certain deposits and initiate an aggressive program to encourage our members to

move their deposits elsewhere. That required change may disappoint our current members, but will certainly aid in protecting the NCUSIF.

On page 44, the proposed rule addresses the treatment of the NCUSIF deposit. The rule proposes to subtract the NCUSIF deposit from both the numerator and denominator of the risk based capital ratio. This treatment is supposed to address the issue of the NCUSIF being listed as equity on the NCUSIF balance sheet and an asset on the credit union's balance sheet. It appears there is a disconnect in the logic of the treatment of this "asset" over the years. From this selected treatment, it makes one wonder if credit unions should have a recorded claim at all against the equity of the NCUSIF. It appears that credit unions should have zero as a recorded asset if the amount of this asset is going to be subtracted from both sides of the equation. The NCUA's position here is very confusing. Either, this is an asset of the credit union in which it has a claim on the NCUSIF, or it is truly a fee assessed by the NCUSIF on a credit union without a specific claim with no value. For if it truly had value there would be no reason to subtract it from the numerator. This provision to subtract the NCUSIF from the numerator should be eliminated.

Credit Conversion Factors (CCF) applied to off balance sheet (page 68) items appear to be too high for the components addressed. For example, the proposed CCF (75%) for Unused MBL commitments (100% risk weight) assumes that every unused line will be filled for the full unused portion. This may very well be true for some unused lines, but certainly not all. The conversion factor seems too heavily weighted for a commitment that may or may not become fulfilled. The same is true for real estate loans with recourse.

The Proposed Risk-Weight for unfunded commitments for Non-Business Loans appears to be too high as well (page 71). Many members want the security of having a Line of Credit available to them. Most of these lines are secured with their primary residences, some of whom already have their first mortgages with the credit union. Most of these lines will not be advanced. These lines are usually associated with a seasoned first mortgage indicating "skin in the game." A risk weight factor of 75% appears to be to be way over the top for these commitments. If the NCUA insists on this Risk Rating, we may be forced to close these lines for our members, add to their inconvenience (re-applying) and providing opportunity for financing outside the credit union community.

Under provision 702.106 Prompt Corrective Action (PCA) for adequately capitalized credit unions, there is a requirement that a credit union must add 10 basis points (bps) of its total assets to its net worth quarterly until it attains a well capitalized status (page 147). This seems like a steep hill to climb for those of us who will experience a reclassification from well capitalized to adequately capitalized. Those credit unions who are well capitalized now and who will experience a downgrade are probably experiencing some unique challenges that will take some time in order to achieve the proposed new ratios. Ten basis points may not sound like lots of money, however, it is to credit unions that now have to change their business models to adapt to these new requirements. Either the percentage needs to be reduced further per quarter, extend the time for achieving the 10 bps (annually versus quarterly) or lengthen the time to achieve the new ratios from 18 months to 36 or 48 months. For credit unions in excess of $250 million and are truly complex, this will provide more time to become compliant or seek merger partners.

If the NCUA is insistent on changing to this new risk based model, then I implore the NCUA to be tolerant of an extended implementation period sensitive to medium asset sized credit unions ($250 - $500 million) expected to implement these changes. This proposal is sweeping and unprecedented.

Therefore, a generous helping of accommodation, forbearance, guidance, knowledge and patience should rule the day.

Thank you for entertaining my thoughts on this ill timed proposal.

Sincerely,

Walter L. Hobby, CPA, CGMA
Chief Financial Officer
CDC Federal Credit Union