May 23, 2014

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

RE: Comments on Proposed Rule: PCA - Risk-Based Capital; RIN 3133-AD77

Dear Gerald Poliquin,

I am writing this letter on behalf of San Francisco Fire Credit Union's (SF Fire) Board of Directors and Senior Management Team to express our concerns with the Risk Based Capital Proposal issued on January 23, 2014. While we agree with and support the rationale that credit unions with low risk operations should require a lower minimum risk-based capital and conversely that higher minimum levels of risk-based capital are necessary for credit unions with concentrations of higher-risk assets, the scope of the risks that the proposed regulation tries to address is too overreaching and the details within proposed computations appear to be flawed.

Too Wide and Varying in Scope

It appears that the NCUA proposal is trying to manage to all risk parameters that impact our industry, including not just the credit risk as BASEL III does for our banking counterparts, but now also interest rate risk, liquidity risk, concentration risk and market risk. The problem with attempting to address all of these risks is that, by nature, these risk characteristics are not mutually exclusive. For example, incenting a credit union to hold short-term assets does address liquidity risk, but also may result in increased interest rate risk, concentration risk and reduce a credit union's ability to sustain a healthy net interest rate margin by forcing investing in lower-yielding assets.

Lacking Historical Perspective

Furthermore, the proposal seems be too reactive to the recent mistakes made by selected credit unions during the most recent economic cycle. The credit union industry has been around for many years and has been successful in navigating through all types of economic cycles. Each time, there are lessons learned and some institutions that fail, but the majority survive and even thrive. This proposal appears to try to inflict regulation on all credit unions in an effort prevent credit unions from repeating some of the sins of the most recent few years. What this does not consider is the fact that while some credit unions got in trouble by having a heavy concentration in real estate or business loans there are many that have always specialized in this area and did not have the same losses. SF Fire has always had a higher percentage of its

loan portfolio in real estate loans, but our underwriting standards have always required that member's have equity in the property, adequate cash flows to service the debt and have a loan structured in a way that is straight-forward and member-friendly. We fear that this proposal attempts to take only the past few years of activity and use this as a way to restrict the future behavior of the industry as a whole.

Concerns Regarding Risk Allocations

When looking at the detail of the proposed computation, SF Fire also has concerns with the risk allocations that are being assigned to specific categories of assets. An area that is especially concerning is the investments area. The NCUA's proposed rule does not consider the type of investment purchased or the underlying issuer of the investment, but rather only considers its weighted-average life. This seems to indicate that the NCUA is only concerned with the liquidity of a credit union's portfolio, and not the quality of the assets within the portfolio. We all know that there are many factors to evaluating the risk within an investment portfolio, and that the risk profile of a 10-year agency bullet as compared to 10-year private label CMO is significantly different. This proposal makes no attempt to recognize or quantify this difference.

Implications Regarding Short & Long Term Assets

Another concern regarding the investment risk allocations is that this proposal is pushing credit unions to invest in short-term assets, which are also those assets that have the lowest yield. It also insinuates that whole classes of assets, such as mortgage-backed securities, have a high risk profile. While that may be true in very specific situations, mortgage-backed securities in general have been a tremendously reliable asset class for decades.

Appropriateness of Specific Risk Weightings

Outside of the investment area, SF Fire has further concerns about the appropriateness of specific risks weightings relative to one another. For example, a delinquent first mortgage loan is proposed to carry a risk weighting of 100%. This risk weighting is the same as the risk assigned to assets such as a building, a prepaid expense, or a foreclosed property. The 100% risk weighting is actually less than that assigned to an investment in a CUSO or any investment that has a weighted average life that exceeds five years. When thinking about the risk profile of all the asset classes just mentioned, a delinquent real estate loan seems to carry a much higher risk of loss to the credit union than any of these other items.

Disincentive Towards Real Estate Lending

When it comes to mortgage servicing rights, SF Fire acknowledges that these can be a volatile asset in terms of its ongoing value; however, the risk allocation in this proposed rule results in penalizing the credit union when it originates and sells the real estate loan or when it originates and retains the loan. Either way, providing real estate lending services to our membership has

a negative impact on the risk-base net worth ratio. If we sell the loan and keep the servicing to maintain the relationship with our member, it will impact the amount of mortgage servicing rights we hold. If we keep the loan in our portfolio that will have an even greater impact to our risk based net worth ratio. Once again, this proposal suggestions that the NCUA is pushing us to be a more consumer loan driven organization, despite the fact that our membership has always had an overwhelming need for real estate lending services. The NCUA should not be the organization that dictates our service offerings to our membership, but rather ensures that the services that we do offer are in the best interests of our membership and comply with all facets of the industries regulations.

Intention to Create Regulatory Parity

The NCUA has noted that these proposed requirements would make the risk-based capital requirements for federally insured natural person credit unions be more consistent with "the regulatory risk-based capital measures used by the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve and Office of the Comptroller of Currency". In actuality, the proposed computation is more conservative than that required under current banking regulations or by Basel III. This proposal will put credit unions at a distinctive disadvantage in that a credit union that has exactly the same balance sheet as its banking counterpart, would have a lower risk-based capital ratio. This problem is magnified even further by the fact that credit unions have no ability to raise capital, as capital can only come from earnings.

We ask that you please consider the items noted above when evaluating the Risk Based Capital Proposal and determining whether any modifications are necessary. SF Fire would like to see changes made to the risk weightings assigned to specific asset classes and also ensure that the computations are equitable to those used by the FDIC, Federal Reserve and OCC.

Sincerely,

Darren Herrmann
President/CEO
San Francisco Fire CU

cc: CCUL