March 31, 2014

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

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

NCUA Board,

As President of Denver Fire Department Federal Credit Union (DFDFCU) I am writing on behalf of management and our Board of Directors. The following outlines our thoughts and concerns regarding NCUA's proposed risk based capital rule.

General Comments and Credit Union Background

DFDFCU proudly celebrated its 75th anniversary last year, and as of March 2014 has $133,682,813 in assets with 5,846 members and 9 full time employees. We consider our credit union a "private" financial institution as only Colorado Professional Firefighters and their families are eligible for membership. Our restricted field of membership affects the organization's growth opportunities challenging management and the Board to develop conservative growth strategies within our limited market. As you are aware, credit unions with less than 6,000 members typically have less than half of our total assets. Where DFDFCU is unique, is in our average deposits per member, which is currently above $20,000 per membership. I state unique as it pertains to credit unions as a whole, but you will find that many of our peer firefighter Credit Unions have much higher "deposit per member" numbers than we do. It's just the demographic makeup of Firefighter Credit Unions. As of June 2013 the average US credit union share balance per member was $9,564. Using this average share balance combined with our 5,846 members and 11% Networth, we would typically be a $62 million Credit Union. Currently, most credit unions are boasting a 60% loan to asset ratio. For our hypothetical $62 million dollar CU, a 60% loan to assets ratio translates to a $37 million loan portfolio. DFDFCU's current loan portfolio stands at $32 million, which is close to the average portfolio for our membership size, but certainly far short of the average loan portfolio based on our asset size.

Why is all of this relevant, and how does this relate RBC? In our Credit Union's past, we didn't need to focus on lending as our low expense ratio, and strong investment portfolio could provide a healthy spread. Since the Fed's ZIRP or Zero Interest Rate Policy was enacted, investments no longer support an adequate spread, so our organization was forced to migrate our balance sheet to a more lending centric model. Using the information presented in the aforementioned paragraph, DFDFCU would need an $80 million loan portfolio to be in an "average" loans-to-assets position, allowing the organization to benefit from an average interest income earnings position. In today's economic environment, loans are the only balance sheet investment option left for Credit Unions (due to ZIRP), so what loan option does a small, wealthy, membership based Credit Union select for its balance sheet? Auto lending is not a realistic option for a closed field of membership institution competing in a large marketplace with both local and out of state organizations using indirect auto lending as loss leader products to membership penetration. In addition, recreation vehicle loans, share deposit secured loans, signature loans, and other consumer loan products will not realistically close the gap between $32 million and $80 million with only 5,846 members. This leaves our organization with only one realistic loan option - mortgage lending.

Clearly, Credit Unions need to understand all the risks of a mortgage centric balance sheet, and we have come a long way developing technology that properly models ALM scenarios that represent large mortgage portfolios in changing rate environments. This isn't the 1980's; and with the right balance sheet mix, mortgage duration and weighted average life positions, risk can be hedged within acceptable

tolerance levels using the right mix of products, rates, and balance sheet diversification. For DFDFCU, mortgage lending must be the key driver for our future business model. DFDFCU has a conservative credit underwriting model; leading to a much lower than average credit loss ratio. I believe strong underwriting, combined with strong ALM practices, strong expense management, and conservative balance sheet management can make a mortgage centric balance sheet a viable business model moving forward. Our current balance sheet per NCUA RBNW calculator demonstrates that we have over 14% in RBC, but with our move into mortgages clearly we will be at a competitive disadvantage against our banking competition due to our higher capitalization requirements.

Are Banks safer than Credit Unions?

Banks can raise capital to meet new BASEL III standards; currently Credit Unions can't raise capital. So it is understandable to a degree, why Credit Unions need slightly higher capital levels to offset risk. In order to meet regulatory ratios, Credit Unions have to right-size their Balance Sheet. Many times this adjustment to fit current capital requirements comes at the memberships' expense. The RBC ruling as constructed to this point, leads our organization to believe NCUA feels Banks are safer than credit unions. For example, how were the asset risk-weightings calibrated? Why, in many categories, are Credit Union levels more stringent than what Banks face under Basel III? The proposed ruling would increase capital by $7.3 billion for credit unions to be "well capitalized". The time period for implementation is short-18 months (banks, under Basel III, were given nine years); and again without the ability to raise capital credit unions will assuredly need more time to make the necessary changes to be in compliance, while ensuring not to penalize our membership through higher costs of conducting business. Congress mandated that Credit Unions have a capital risk comparable to other regulators systems, i.e. FDIC, so why do we have the proposed disparity in risk ratings, requirements, and time to raise the necessary capital to adhere to the new ruling?

As I continue through our concerns, I will focus the majority of my thoughts on mortgage lending and mortgage assets to keep a consistent model regarding the effects of the proposed ruling.

Capital Adequacy – Part 702

Not that I believe that BASEL III is a perfect risked based capital plan for Banks, but I do believe it comes closer than NCUA's proposed RBC plan. NCUA should look at its primary mission of safety and soundness, and question the true needs of this proposal. How should the design standards differ from banks, and why? Should the weightings be focused more on Credit Risk or Extension Risk?

Capital is used as an "Insurance Policy" if risk is mismanaged, or the economy takes a turn for the worse creating liquidity shortages. I have always felt that as Credit Union Management we act daily as Professional Risk Managers. It is NCUA's purpose to protect consumers and ensure we are managing risk properly, while always understanding that it is impossible to eliminate risk. Unfortunately every incident or economic event that negatively affects the economy and the industry as a whole creates a new regulation that is designed to eliminate the risk realized due to the latest event. I sincerely hope NCUA and all regulators for that matter understand that all financial institutions make money by managing risk. If the day ever comes when regulation does eliminate the majority of risk from our model, we will be out of business as there will be no spread creating revenue.

Capital Adequacy – Part 702 104(b) Capital Ratio Numerator

NCUA's proposal stating that it intends to subtract the NCUSIF deposit from the denominator is contradictory on many levels. The NCUSIF deposit is recognized on our balance sheets and confirmed by our CPA's as an investment, so from a GAAP perspective, to subtract it from the calculation would violate the accepted practice that designates it as an investment. Doesn't look like you can have it both ways, should NCUA then just refund our NCUSIF deposits, and bill us for agency expenses and losses?

Risk Based Capital by its very definition provides adequate equity and reserves to cover losses. Since all financial institutions on the other side of the balance sheet have additional loan loss reserves allocated in ALLL accounts available to cover loan losses without taping capital, RBC can be thought of as a secondary level of risk funding regarding loan losses. By setting a 1.25% of risk asset limit, seems to

undervalue ALLL and runs counter to capital measurement for adequate levels of funds available for loss. NCUA should allow the entire balance in the ALLL to be included in the numerator or capital.

Capital Adequacy – Part 702 104(c) Risk-Weights for On-Balance Sheet Assets

The newly proposed BASEL III for banks is very advantageous over Credit Unions since it weights all mortgage lending at 50%. For the Credit Based model NCUA appears to have created a more complex weighting model based on interest, concentration, and credit risks.

Given that NCUA believes that all Credit Unions over 50 Million in assets are deemed complex Credit Unions, then it would also be reasonable to assume that those complex Credit Unions would be using sophisticated ALM tools to manage their risks. All Credit Unions balance sheets are different, and to try and develop blanket regulations for a "one size fits all" approach to manage mortgage risk will not work. This would have been proven out during the last economic downturn when the "Sand States" risks were much greater than other parts of the country. Let Credit Unions manage their balance sheets with good ALCO plans that work for their Credit Union model. As stated above our Credit Union is moving towards mortgage based lending, so a competitive market disadvantage (like the proposed RBC ruling) for our Credit Union as well as others would drive us all out of the mortgage market. A simple risk weighting at 50% comparable to Banks would be my suggestion.

Second Mortgages, i.e. junior lien mortgages, including HELOC's obviously carry more credit risk being in a subordinate position to the first mortgage. Properly underwritten "Seconds" can have the risk compensated for with higher and variable rates, shorter terms, and better LTV's. A strong variable rate HELOC loan portfolio can help manage the interest rate risk of the Credit Union's overall loan portfolio. Again as stated above with First Mortgage loans it is our opinion that a strong ALM program will help manage the interest rate risk for and concentration limits of all assets. Therefore leave second mortgage lending with the risk weighting of 50%.

The majority of our balance sheet is currently dominated with US Government backed obligations, Treasury's and Agencies. All obligations are backed by the full faith and credit of the US Government, which historically has been modeled by our ALM program and Investment Policies with no credit risk. We are struggling to understand the logic used when comparing the credit risk weighting of a 30 year 1st mortgage product (at 100%), and the US Government backed, no credit risk, rated WAL ratings from 3-10 years with a 75% to 200% risk weighting. I would hope that we can still all agree that we can remove credit risk from US Government Back securities, and our recommendation would be to follow BASEL III proposal with a flat 20% risk weighting no matter how long the term is. The Credit Unions capital would never be at risk or lost as long as the investments are held to maturity, which is the justification for the 20%.

According to this proposed regulation, our Leadership Team is led to believe the most dangerous assets a Credit Union can invest in are CUSO's and Corporate Credit Unions. The proposed regulations would give a 200 percent risk weighting for corporate credit unions and a 250 percent risk weighting for CUSO investments. Credit Unions by their very nature, scale, and size thrive and were founded on their cooperative nature. What sense would it make if Denver Fire Department FCU could invest into a CUSO that could save the organization hundreds of thousands per year, increase efficiencies, and create strength and redundancy in its staffing, only to be faced with a very stiff capital penalty from the regulator? Credit Unions do need to get better at selecting good business partners, but quite frankly we have all made mistakes, and we will continue to make them no matter how much due diligence we complete on our prospective vendors. Selecting a good business partner is much akin to making a good loan, usually they workout great, but occasionally they fail.

Corporate Credit Unions with NCUA Reg 704 have essentially no risk on their balance sheet, other than the Corporates that still retain a portion of their "Legacy Assets". NCUA has driven them to a fee based model, in which scale and expense management will be the key driver of their future success. In 2016 and 2020 Corporates will also be hindered by NCUA's requirement to subtract members' contributed capital from their totals. Of course this discount to capital regulation does not follow Generally Accepted Accounting Principles, and requires corporates to add RUDE levels that could cause many Corporates to

assess additional fees. How much double / triple /quadruple capitalization is necessary in this corporate model?

In closing

In the recent economic downfall Credit Unions provided vital and much needed countercyclical lending to consumers and businesses when Banks turned off credit. If this new Risk Based Capital Rule were to be in place for the next economic downtown, my fear is that Credit Unions would not be able to lend when it is so vitally needed.

The competitive disadvantage NCUA's RBC proposed rule would place on credit unions, would force Credit Unions to charge higher loan rates to generate the greater amount of revenue required to fund the reserves being proposed, as opposed to the reserves being required for banks. Our fear is that the regulatory burdens placed on Credit Unions will very likely lead to an unbalanced competitive marketplace due to the fact the proposed legislation will force many credit unions to adapt to a more restrictive business model to compete. How many Credit Unions once they hit $50 million in assets and are now deemed “Complex” will pushed out of business, or is this an incentive to stay small and die a slow death of no asset growth? If the credit union is unwilling or unable to adapt to the more restrictive model, it may likely force many institutions to close, merge, or switch charter to a Bank where the capital requirements are not as strict and the ability to raise capital exists. We would like for NCUA to consider that a simple leverage ratio is still the best approach for setting capital levels for all financial institutions.

Respectfully,

Mark Lau
President
Denver Fire Department Federal Credit Union