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May 23, 2014

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

Re: Risk Based Capital Proposal

Dear Mr. Poliquin:

Thank you for the opportunity to comment on the proposed changes to the NCUA's capital requirements. We believe that the proposal is likely to have an injurious effect on credit unions, by restricting our capacity to fulfill the mission of our charter, limit credit unions capacity to compete, and constrain innovation and creativity. We support strengthening credit union capital to offset risks, but we believe that the proposed Risk Based Capital (RBC) regulation will place credit unions in an unfair competitive disadvantage in the financial market place. We believe that Basil III is a capital model that the NCUA could adapt to credit unions. In this way credit union capital requirements would be similar to banks allowing credit unions to be competitive and not be disadvantaged by unfair and more stringent capital requirements.

Fort McClellan Credit Union is well capitalized under both measures, however our capacity to remain well capitalized is reduced under the proposed risk based formula. There is a significant opportunity for credit unions to attract new members and become a larger player in the financial industry, as banks become less consumer friendly and continue to impose new and higher fees. We believe that new capital requirements are not needed as natural persons credit unions have performed satisfactorily during this prolonged economic downturn. However, since some reform seems inevitable, we strongly recommend that the Basil III model be adopted and modified for credit unions.

Our comments, concerns, and suggestions are listed below for your consideration.

1. **NCUSIF Deposit** – The proposal does not include any allowance for the NCUSIF Deposit. This suggests that the NCUA does not consider the NCUSIF to have any value and because of this may have implications as to the accounting treatment of this amount. If the NCUSIF deposit has value, as we believe it does, then it should be

included in the calculation and not deducted. Also, credit unions should receive full credit for the 1% Capital contribution to the Share Insurance Fund.

2. **Allowance for Lease and Loan Losses** – The proposed 1.25% penalizes those credit union that follow Generally Accepted Account Principles as ALLL should properly reflect was is required by the FASB. In addition, it will limit further restrict and incentive to make loan to members with bruised credit. This will hamper our ability to make loans many of our members that have suffered job losses or other financial hardship in the past, but are creditworthy today. There is no needed for the NCUA to provide an incentive for credit union management to grant loan to qualified members and record loan losses in a timely manner. There are still parts of this country that are feeling the effects of the Great Recession. These sections will be unjustly punished by the proposed 1.25% restriction, when no restriction is need.
3. **Goodwill** – should be included in the RBC calculation. Goodwill is included on a credit union's balance sheet, due to a merger. It recognizes the economic value of the credit union being merged. This treatment of Goodwill is likely to hinder future merger activity between healthy credit unions; therefore, we recommend that Goodwill be included in the RBC calculation.
4. **Investments** – Focusing on maturity alone is a mistake as maturity is but on measures the interest risk for an investment and does not consider any adjustable rate features. In addition, it is not considering the credit risk or the issuer. Also, the risk weight for a 5 to 10 year investment at 150% seems overly punishing. It implies that the NCUA considers a Mortgage Backed Security with an average life of 7.5 years to be 3 times as risky as a 15 year mortgage loan made to a member and held in the credit union's loan portfolio. Investment in the 5 to 10 year bracket should be risk rated at 25%.
5. **Loans** – Consideration should be given for the variations in the type of real estate loans that a credit union offers. Variable and fixed rate mortgage and 10, 15 20, and 30 year loans should be weighted differently. Not all real estate loans pose the same risk exposure and therefore real estate loans should not be combined into one risk pool. Requiring that the first 25% of mortgage assets be risk rated at 50% does not properly take into consideration variations in loan products. Also, risk weighting a 30 year mortgage loan in a credit union's portfolio at 50% and a Mortgage Backed Security with a 7.5 average life at 150% does not seem proper. The risk capital risk burden should be 25% for 15 years and less and 50% for 15 to 30 years.
6. **Member Business Loans**- Although it is true that Low Income Designated credit unions are not subject to the Member Business Loan cap of 12.25% of assets, I believe that the proposed threshold of 15% of assets is too low to begin requiring more capital. A more appropriate level is 25% of assets. At 25% of assets business loans require more scrutiny and some additional capital consideration.
7. **Investment in CUSO's** – There are many well run and capitalized CUSO's that benefit multiple credit unions. The risk based requirement of 250% the investment in a CUSO is overly burdensome and will discourage the future formation and investments in CUSO's. This cost in turn will stifle innovate business solutions and service opportunities among credit unions. The risk weighting for CUSO's should not exceed 100% of the credit union's investment.
8. **Mortgage Servicing Right** – The concept for credit union's retaining Mortgage Servicing Rights (MSR) once the mortgage loan is sold to an investor is to maintain and grow the member relationship. A member is likely to do most of their "banking" with the financial institution that services their mortgage. The credit union reduced its risk by selling the long-term mortgage and is now penalized by a high 250% capital requirement for retaining servicing rights and the member relationship. These

relationship lead to additional benefits to the member and income sources to the credit union. This does not make sense if the mortgage is sold without recourse which exposes the credit union to minimum risk with proper accounting. However, if the mortgage is sold with recourse, making it subject to repurchase, then a risk weight of 100% would be reasonable.

9. **Asset/Liability Management** - requires managing the risk on both sides of the balance sheet. The Risk Based Capital Proposal only addresses the asset side. There are implications for funding assets with these proposed risk weightings on the liability side. Proper liability management can offset asset risks, and reduce the capital required. A properly managed balance sheet can significantly reduce risk. This should be considered when addressing the amount of risk based capital that is needed.
10. **Off-balance Sheet items** – are unfunded commitments primarily for credit cards and HELOC's that are included in the asset totals. There is no exposure to the credit union until they are used. Reserving for unfunded commitments will reduce these offering and reduce member options, but will not reduce liquidity risk. Also, there is no consideration being given to the liability side, unused lines-of-credit that could be used to offset some of the risk. Additionally, the 75% conversion ratio for unfunded business loans is severe, especially if there is no ability to offset the risk on the liability side.
11. **Time to Implement RBC standards** – The proposed 18 month period is too short considering the type of balance sheet restructuring that many will have to perform. Credit Unions should be given a reasonable time period to comply with a regulation has such far reaching impact on a credit union balance sheet and strategic plan as this one does. We suggest a period of at least 3 years, but highly recommend that the implementation period should be extended to 5 years.
12. **Restricting Dividend Payments** – The proposal restricts the ability for a credit union to make dividend payments below a 6% Net worth Ratio. This may prove to be problematic in times of future recessions, and other unforeseen economic factors effecting market fluctuations. It also restricts credit union Boards ability to manage the liability side of the balance sheet along with the asset side, causing additional stress on a struggling credit union. Therefore we recommend that this threshold be lowered to 5%.
13. **Individual Minimum Capital Requirements** – We have significant concerns about the NCUA's authority to require a higher minimum risk-based capital ratio for an individual credit union in any case where the circumstances, such as the level of risk of a particular investment portfolio, the risk management systems, or other information, indicate that a higher minimum risk-based capital requirement is appropriate. The additional capital requirements would be over and above the objective risk-weighting system implicit in the proposed risk-based capital ratio calculation. NCUA's determination of whether a credit union would be subject to an individual minimum capital requirement would be highly subjective. Even though the proposed RBC requirements have a process to challenge a higher capital requirement, it is highly unlikely that such a challenge would be successful since the agency has already made the determination that more capital is needed. The NCUA is concerned that in the past it did not have regulatory authority to force a credit union to provide adequate reserves to offset potential risks for activities that the credit union was engaged in. However, is the NCUA the best resource to assess the risk of the activity and the additional capital required for that activity? Can an independent third party be used to access the risk? If the credit union is engage in what is perceived to be a high risk activity by the NCUA, will the regulator be willing to provide an objective assessment of that risk? Is it not

more likely that the NCUA will provide a subjective overly conservative assessment of the risk and the capital required to offset that risk?

Summary – There does not appear to be a need for such a drastic change in the capital requirements for credit unions. Natural Person Credit Unions as a whole weathered the Great Recession and were not significant contributors to its cause. Because of this, the need to change the capital requirements in such a harsh approach is questioned. This is especially true as our analysis of the proposed RBC requirement will harm credit unions capacity to fulfill the mission of our charter, limit credit unions capacity to compete, and constrain innovation and creativity.

The NCUA's Risk Based Capital proposal will place many credit unions at a competitive disadvantage and greatly restrict their ability to provide the financial services that their members require. It will also limit credit union adeptness at serving a diverse economic spectrum of members, including low income, credit impaired, disadvantaged groups that depend on credit unions the most and the people that credit unions were initially formed to serve. The proposal attempts to eliminate all the business risk that credit union faces. However, like any business credit unions are in business to take calculated risks, and do so every day as we make loans to our members. These proposed capital requirements will greatly hinder the capacity of many credit unions to offer products and service to earn sufficient income to be competitive and build the required reserves. Credit unions are facing increasing cost and regulatory burdens on multiple fronts, including health care, and CFPB regulations. I understand that there is a need in some sectors of the financial service industry to strengthen capital requirements, but as not-for-profit cooperatives credit unions capital structure, including the ability to raise capital, are different than for profit institutions. Credit unions conservative nature has allowed them to perform satisfactorily without the need to capital reform.

NCUA should tailor any new capital requirements to reward and encourage credit unions to build capital and address balance sheet risks. This proposed appears to be constructed to discourage credit unions from engaging in any new and creative product and services, from considering merger opportunities, or even from collaborating in CUSO ventures. Basil III is a capital model that the NCUA could adapt to credit unions. In this way credit union capital requirements would be similar to banks allowing credit unions to be competitive and not be disadvantaged by unfair and more stringent capital requirements.

Thank you for the opportunity to comment of this important and potential far reaching proposal.

Sincerely,

Richard H. Simonton, Sr.
Vice President