COMMUNITY first
CREDIT UNION

May 19, 2014

Mr. Gerard Poliquin
Secretary, NCUA Board
1775 Duke Street
Alexandria, VA 22314-3428

Ref: NCUA Risk-Based Capital Proposed Reg

Dear Mr. Poliquin:

I am the Chief Executive Officer of Community First Credit Union. I have been in the credit union industry since 1985. In addition to my almost 30 years of managing credit unions I am a registered CPA and hold a Masters of Business Administration with emphasis in accounting an taxation.

I appreciate the opportunity to comment on the proposed Risk-Based Capital regulation. I see Chairwoman Matz in the trade press recently stating that the NCUA will consider "sensible reasons" for changes to the regulation. Since these comments and many others will stand in stark contrast to what the NCUA proposes I pray that the NCUA will have an open mind and not simply consider all criticism and suggestions as non-sensible.

I also understand NCUA's desire to update the risk based capital criteria for credit unions and my suggestions are ways that the NCUA could reasonably alter the current proposal.

My primary concern with the proposed regulation can be summarized by its lack of basis on any analytical foundation. Instead it appears to be based on the fears created by a very few credit union mistakes and losses during the financial crisis. If the NCUA is taking this opportunity to update its risk-based measurements, let's use sound analytical data, not subjective opinions. The credit unions and our members deserve better.

1 – Lack of justification for increased capital

The NCUA is increasing overall capital requirements with this proposal without demonstrating a need for increased capital. During the financial crisis the loss ratio for credit unions was $0.26 per $1,000 insured, compared to $2.30 per $1,000 for banks. The facts are that credit unions already have sufficient capital and have less risky balance sheets than banks. However, this proposal increases the capital requirements for credit unions in spite of the facts that indicate the need for otherwise.

2 - Subjectivity

The proposal contains many subjective aspects. And subjectivity is fully integrated in the proposal in section 702.105 (c) - "*minimum capital…based, in part, on a subjective judgment grounded in agency expertise*."

First, it is astounding that after the last five years the agency asserts they have any reliable "agency expertise". Let me list just a few of the ways the agency has missed the mark widely in the last five years.

a) In spite of having examiners on site at corporate credit unions the NCUA completely missed the risk building in corporate credit union balance sheets and the ultimate losses that risk caused.

b) In the aftermath of the corporate meltdown, the NCUA widely missed estimating what the losses would be. During that time our credit union commented to the NCUA that their proposals to immediately expense those losses was erroneous and was causing estimated corporate losses to become real natural person losses. We distinctly remember the response - David Marquis the Executive Director at the time replied - "the losses are REAL". After the recent large, multi-billon dollar revisions to those loss estimates I can't help but ask if Mr. Marquis still feels the same way today?

c) More recently Chairwoman Matz in a CU Journal article published on January 6, 2014 states that "rates have started to rise, so it's not a matter of when anymore, it's how much." Apparently, Ms. Matz believes she can predict movements in interest rates. And this is reflected in the risk based capital proposal by including a bias against a credit union managing that risk for all environments substituted with regulatory bias against longer term assets. This ignores the possibility the there are other interest rate scenarios and ignores the liability side of the balance sheet. Since the time of Ms. Matz's bold prediction rates actually have fallen. The 10-year treasury on January 6^{th} was 2.98% and today stands at 2.63%. Despite Ms. Matz's assertion, perhaps "when" is still a question. I pray the NCUA and the Chairwoman is humble enough to admit that perhaps they are not all knowing.

   Conceivably, there could be another economic cycle wherein Ms. Matz predicts interest rates will fall, and thus it would be advantageous for credit union to hold longer-term assets. Yet, this regulation would still discourage longer-term because it is permanently hard coding the current economic cycle into regulatory mandate. That seems misguided to us.

d) During the midst of the crisis our March 2009 regulatory examination read like a death sentence. The "agency expertise" concluded we were on shaky financial footing and we felt the heavy hand of the regulators. The subsequent facts suggest otherwise, management knew our balance sheet better than the examiners. We knew that our risks were well managed and we went on an expansion spree opening three new offices in the next year. Proof that we knew better - over the last five years our capital has increased 84% and grown from 6.24% to 8.77%. I can only imagine what poor shape this credit union would be in if we were subject to this very subjective rule and the subjective "agency expertise" five years ago. Thankfully the rule was not in place and we were still allowed to manage the credit union. This may surprise the NCUA, but credit unions actually have some management expertise as well. And, we avoid the hubris of trying to predict interest rates and instead manage to various interest rate scenarios.

The NCUA needs to amend this proposal to remove the areas wherein they assume they know better than credit union management and regulate that belief in very subjective ways.

3 - Concentration Risk

The proposal is also biased against concentration risk to an excessive degree. While we agree that concentration risk should be managed by a credit union, the proposal's management of concentration risk is crude, unsophisticated, and misguided. The bias of the proposal again ignores the facts in favor of subjective opinion. First, it is a generally accepted business principal that any business should focus on what they know best. I'm sure we are all familiar with the phrase - 'stick to your knitting'.

For example, our credit union has built an expertise in indirect vehicle lending, indirect sub-prime vehicle lending, and real estate lending. An examination of our loss ratios for each of those portfolios will substantiate my claim that we are experts in these fields. Yet, every year, despite a full, complete, objective, and long-term analysis of our indirect sub-prime portfolio, the NCUA examiner complains about the risk therein. This evidences two problems with the proposal. First, the proposed regulation would give an examiner with a very negative but <u>subjective</u> assessment of our sub-prime portfolio control to take over the management of credit union. Overriding the many years of management expertise, replaced by the subjective opinion of the examiner whom probably spent a total of 3 weeks at the credit union. Second, the proposal has a bias for diversification for the sake of diversification, again, regardless of the facts.

Furthermore, an analytical approach will demonstrate the fallacy of the NCUA's position. An analysis of mortgage loan losses in comparison to mortgage loan concentration will show an inverse relationship - losses are lower for credit unions with higher concentrations of mortgage loans. It appears the NCUA prefers to rely on subjective and outdated beliefs rather than study what would actually reduce losses to the NCUSIF.

In summary, the NCUA has not provided any analytical support for the risk based capital proposal from the need for higher capital, the ability for examiners to subjectively change the capital requirement for an individual credit union, and for their risk weighting of various asset classes.

Instead, you have created a very subjective and unsubstantiated proposal that will have numerous unintended consequences to the detriment of natural person credit unions. Just as the new corporate credit union regulation has caused corporate credit unions to be a shadow of their former selves, this proposal will have the unintended consequence of reducing risk in credit union balance sheets to the point that we become irrelevant to our members and eventually shrink to non-existence.

I recommend the NCUA start over with a little more humility, objectivity, and substantial input from credit unions.

Sincerely,

Todd

Todd Sheffield
Chief Executive Officer