American Heritage
FEDERAL CREDIT UNION

May 21, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

Via email to regcomments@ncua.gov "AmHFCU – Comments on Proposed Rule:PCA-Risk-Based Capital"

Dear Mr. Poliquin,

American Heritage Federal Credit Union (AmHFCU) appreciates the opportunity to comment on the National Credit Union Administration (NCUA) Board's proposal to revise Prompt Corrective Action related to Risk-Based Capital. AmHFCU is a low-income designated credit union serving the county of Philadelphia, PA as well as 800+ select employee groups in Pennsylvania. We have 130,000 members and $1.4 billion in assets.

Overall, the Risk-Based Capital proposal will have negative effects on AmHFCU members and discourage investment in long term strategies necessary for the continued growth of the credit union. AmHFCU is asking NCUA to consider revising risk weightings to more reasonably assess concentration and interest rate risk and to better align the proposed risk-based well-capitalized requirements to existing net worth requirements. Under the proposed risk-based capital rule, AmHFCU will see its well-capitalized buffer fall 99%, to $341,000 from $34,762,000. This will force management to cease the growth business model in order to build up its capital and negatively impact the member experience.

We have the following comments in the following areas:

Cash Held at the Federal Reserve

Proposal: The Risk-Based Capital proposal assigns cash held at the Federal Reserve a 20% risk weighting.

Comments: AmHFCU has been holding large amounts of cash at the Federal Reserve ($75-$100 million) as an alternative to short term investments and as a source of liquidity should there be an increase in the utilization rate on unfunded lines of credit or an outflow of non core deposits in this historically low rate environment. Given that the Federal Reserve has been designated as a source for emergency liquidity for the entire credit union industry, there appears to be little risk in holding cash balances at the Federal Reserve. Under Basel III, central bank reserves are deemed to be highly liquid assets during a time of stress and carry a 0% risk weighting. By lowering the risk-

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weighting for cash held at the Federal Reserve from 20% to 0% on the approximate $100 million we have been investing overnight, frees up $20 million of capital and significantly helps reestablish some of the well-capitalized buffer that was eliminated by NCUA's risk-based capital proposal.

Recommendation: We recommend that cash balances held at the Federal Reserve be given a 0% risk weighting.

Investments

Proposal: The Risk-Based Capital proposal assigns guaranteed investments no risk-weight and for the remaining securities uses the maturity of an investment to identify risk as noted below:

- For NCUA or FDIC investments, the proposed risk-weight is 0 percent.
- For US Government investments, the proposed risk-weight is 0 percent.
- For investments with 0-1 year WAL, the proposed risk-weight is 20 percent.
- For investments with 1-3 year WAL, the proposed risk-weight is 50 percent.
- For investments with 3-5 year WAL, the proposed risk-weight is 75 percent.
- For investments with 5-10 year WAL, the proposed risk-weight is 150 percent.
- For investment with 10+ year WAL, the proposed risk-weight is 200 percent.

Comments: The proposal uses the same maturity buckets in the current call report's statement of financial position page 1. This is a logical extension of the call report.

We are pleased that the weighted average life (WAL) definition has been retained in the risk-based capital proposal and variable rate securities will continue to carry lower risk-weightings than longer term securities. However, we are concerned that the risk-based capital proposal does not adequately capture extension risk before it happens. We purposely purchase DUS bonds with a 5-10 year maturity horizon knowing that as interest rates rise, the maturity will not extend and our investment will roll down the yield curve, further insulating our investment from interest rate risk. We do not purchase as many fixed rate maturity mortgage-backed securities with a relatively low WAL as many other credit unions knowing that the WAL will extend significantly as interest rates rise.

We are also concerned about the proposal restricting our ability to purchase step-up securities. We purchase up to 15 year step up securities with high initial rates or rates that will increase every year, such that they are likely never to reach maturity, even if rates do rise. By basing WAL on the maturity date for step-up securities, we will have to keep too much capital on hand. WAL should be defined for step-up securities to incorporate the likelihood of the investment being called.

We have investments purchased through Section 701.19 of the Federal Credit Union Act that are managed by third-parties. These investments are in common stock and bonds of corporations that are "non-permissible" as direct investments made by the staff of AmHFCU. These should carry increased risk-weights. In addition, the financial meltdown of 2008 was partially caused by the purchase of private-label asset-backed securities which carried no guarantees. The Government Sponsored Entities' (GSE) asset-backed securities that carried the implied guarantee of the US government did not cause losses to the investors. Therefore, we believe that securities expressly guaranteed by the US government (GNMAs) and securities issued by GSEs (FNMA, FHLMC, FHLB, FFCB, TVA) should be grouped together and differentiated from non-government sponsored entities.

Furthermore, concentrations within an investment portfolio are not being considered, be it guaranteed versus non-guaranteed investments, or issuer concentration, or type concentration, or index concentration. We believe that diversification is a mitigating factor that should be considered provided that the cost and data collection efforts can be minimized. Due to the limited investment alternatives that a credit union can purchase, capturing risk between guaranteed versus non-guaranteed investments will adequately capture the risk profile.

In comparing the proposal to other risk-based standards in place, for those investments that credit unions are permitted to make, the FDIC does not incorporate interest rate risk into the investment risk-weights for community banks. Instead, it weighs the investments that credit unions can do with a single risk-weight of 0% for securities issued or guaranteed by the US government (GNMAs) and 20% for securities issued by and other claims on the US Government or its agencies which are not backed by the full faith and credit of the US Government (GSEs), regardless of maturity. We recommend comparable risk weights.

Recommendation: We realize that some of our concerns cannot be captured easily in the data-collection efforts of the call report, therefore, we recommend that the Risk-Based Capital proposal be modified to give reduced risk-weighting to guaranteed and GSE paper and reduce the weighting for securities that have a shorter WAL than proposed.

Guaranteed and GSEs:

- For investments with 00-01 year WAL, the proposed risk-weight is -0- percent.
- For investments with 01-03 year WAL, the proposed risk-weight is 5 percent.
- For investments with 03-05 year WAL, the proposed risk-weight is 10 percent.
- For investments with 05-10 year WAL, the proposed risk-weight is 20 percent.
- For investments with 10+ year WAL, the proposed risk-weight is 50 percent.

Non-Guaranteed:

- For investments with 00-01 year WAL, the proposed risk-weight is 10 percent.
- For investments with 01-03 year WAL, the proposed risk-weight is 25 percent.
- For investments with 03-05 year WAL, the proposed risk-weight is 50 percent.
- For investments with 05-10 year WAL, the proposed risk-weight is 75 percent.
- For investment with 10+ year WAL, the proposed risk-weight is 100 percent.

Investments in Federal Home Loan Bank

Proposal: It is difficult to determine what risk-weight the Risk-Based Capital proposal assigns to the Investment in the Federal Home Loan Bank

Comments: The current call report indicates that the maturity bucket for risk-based net worth for the Investment in the Federal Home Loan Bank is greater than 1 year but less than 3 years. Such category would equate to a 50% risk-weight under NCUA's proposal. It is unclear in the Risk-Based Capital proposal whether the maturity definition of the investment of the Federal Home Loan Bank will be defined in the current definition of 1-3 years or extend to other investments similar to corporate credit union non-perpetual capital with a 100% risk weight or corporate credit union perpetual capital with a 200% risk-weight.

The investment in the Federal Home Loan Bank is a requirement to access the FHLB system in order to perform on-balance sheet hedging strategies. These strategies reduce the interest rate sensitivity of AmHFCU's balance sheet. Increasing the risk-weight from the current risk-weight would impede our desire to hedge interest rate risk going forward. We do not believe this is something NCUA desires.

In comparing the proposal to other risk-based standards in place, the FDIC has assigned the book value of paid-in Federal Home Loan Bank stock a 20% risk-weight.

Recommendation: We recommend that the Risk-Based Capital proposal be modified to define the book value of paid-in Federal Home Loan Bank stock a 20% risk-weight.

Non-Delinquent First Mortgage Real Estate Loans

Proposal: The risk-based capital proposal uses non-delinquent first mortgage real estate loans (NDFMREL) concentrations to establish risk-weights as follows:

- For <25% of assets, the proposed risk-weight is 50 percent.
- For 25% to 35% of assets, the proposed risk-weight is 75 percent.
- For >35% of assets, the proposed risk-weight is 100 percent.

Comments: Unlike the investments above, the risk-weights for loans do not take into account their various maturity or repricing terms. A 30 year non-delinquent mortgage carries the same risk-weight as a 1 year adjustable rate mortgage and a 15 year fixed rate home equity loan carries the same risk-weight as a variable rate home equity line of credit. Over the past 2 years, AmHFCU has sold or participated almost all of its 15 and greater maturity fixed rate mortgage loans, leaving fixed rate mortgage loans on its books that are seasoned with a significantly lower average life than the stated original maturity. In addition, many of our home equity lines of credit are first mortgage lines of credit that are immediately repriceable and tied to prime. Non-delinquent first mortgage real estate loans should incorporate repricing characteristics and or weighted average lives into their risk-weights.

Most-important to AmHFCU is our strategy to mitigate interest-rate risk through on-balance sheet hedging strategy of borrowing advances from the Federal Home Loan Bank in a matched-book strategy. AmHFCU hedges its $250 million first mortgage portfolio (18% of balance sheet) with $190 million of advances (13% of balance sheet), therefore, we have only $70 million of un-hedged first mortgage portfolio (5% of balance sheet). This is not apparent by concentrating the risk based capital calculation solely on assets. We have not begun to incorporate risk mitigation efforts through the use of derivatives, and at this time, not certain that we will deviate from our traditional hedging strategy, but derivatives may also play a role in the industry going forward. When NCUA performs its 17-4 calculation on loans, we are classified as High-Risk, however, the same 17-4 calculation performed net of FHLB advances on loans, we would be classified as Low-Risk. Under the risk-weight capital proposal, there would be no difference between AmHFCU's capital requirement and the capital requirements for a credit union that holds all 30 year mortgages on its balance sheet. AmHFCU believes that the risk-weighted capital proposal for shorter maturity fixed rate mortgage loans and risk mitigation efforts of on-balance sheet borrowings should be incorporated into the final version of the risk-weight proposal.

The risk-weights also do not take into consideration any of the following factors that could indicate that the loans are more or less likely to be collected, including

- the loan-to-value ratio of loans, or
- the credit scores of members, or
- salability of loan to secondary mortgage participants (DU eligible or not), or
- size of loans, such as jumbo mortgages.

These factors should be used to lower the amount of capital required to be held for loans that are safer than others. Since it will be difficult to capture the above factors into a credit-union wide capital standard, using remaining maturity will imply some of these attributes. As a mortgage repays and the LTV decreases during normal times, such mortgages becomes significantly less risky. The remaining term to maturity is the best, unique factor that incorporates some of the items that would not otherwise be able to be captured on a call report.

One reaction we will make as a result of the proposal is to research through our third party firm, Visible Equity, how many of our second mortgage loans and lines of credit are in a first lien position. We will then create different loan types within the second mortgage general ledgers so that these loans can be reported on the call report and in the risk-weighted capital proposal in the appropriate categories in order to properly reflect the risk within AmHFCU.

Lastly, in comparing the proposal to other risk-based standards in place, the FDIC weights non-delinquent first mortgage real estate loans at 50 percent regardless of the concentration in the portfolio.

<u>Recommendation</u>: We realize WAL may be difficult to monitor in a loan portfolio, therefore we recommend a risk-weighted proposal based on the lower of repricing date or maturity, net of on-balance sheet hedging strategy, in 5 year increments, using the Proposal's risk-weights as the worst case and reducing the risk-weights as a mortgage becomes closer to maturity, such that it will incorporate demonstrated repayment ability, as follows:

For NDFMREL, net of hedging balances, are less than 25% of the balance sheet, risk-weights as follows:

- For NDFMREL with 00-05 year maturity/reprice, the proposed risk-weight is 5 percent.
- For NDFMREL with 05-10 year maturity/reprice, the proposed risk-weight is 10 percent.
- For NDFMREL with 10-15 year maturity/reprice, the proposed risk-weight is 20 percent.
- For NDFMREL with 15-20 year maturity/reprice, the proposed risk-weight is 30 percent.
- For NDFMREL with 20-25 year maturity/reprice, the proposed risk-weight is 40 percent.
- For NDFMREL with 25-30 year maturity/reprice, the proposed risk-weight is 50 percent.

For NDFMREL, net of hedging balances, are greater than 25% but less than 35%, we recommend increasing each percentage above by 25 basis points such that it would be:

- For NDFMREL with 00-05 year maturity/reprice, the proposed risk-weight is 30 percent.
- For NDFMREL with 05-10 year maturity/reprice, the proposed risk-weight is 35 percent.
- For NDFMREL with 10-15 year maturity/reprice, the proposed risk-weight is 45 percent.
- For NDFMREL with 15-20 year maturity/reprice, the proposed risk-weight is 55 percent.
- For NDFMREL with 20-25 year maturity/reprice, the proposed risk-weight is 65 percent.
- For NDFMREL with 25-30 year maturity/reprice, the proposed risk-weight is 75 percent.

For NDFMREL, net of hedging balances, are greater than 35%, we recommend increasing each percentage above by 25 basis points such that it would be:

- For NDFMREL with 00-05 year maturity/reprice, the proposed risk-weight is55 percent.
- For NDFMREL with 05-10 year maturity/reprice, the proposed risk-weight is 60 percent.
- For NDFMREL with 10-15 year maturity/reprice, the proposed risk-weight is 70 percent.
- For NDFMREL with 15-20 year maturity/reprice, the proposed risk-weight is 80 percent.
- For NDFMREL with 20-25 year maturity/reprice, the proposed risk-weight is 90 percent.
- For NDFMREL with 25-30 year maturity/reprice, the proposed risk-weight is 100 percent.

Loans Held for Sale

Proposal: The Risk-Based Capital proposal sets the risk-weight for loans held for sale at 100%.

Comments: AmHFCU and our majority-owned subsidiary, First Heritage Financial LLC, originate some mortgage loans with the intent of selling them within 30 days. On the call report, these loans are categorized as held for sale. The loans are underwritten to secondary market underwriting standards of Federal Housing Association, Federal National Mortgage Association and United States Department of Agriculture prior to closing, the same as our first mortgage loans held to maturity. Since they are sold within 30 days and carry no greater risk that NDFMREL that are classified at 50% in our proposal, the risk-weighting should be less than 50%. Loans held for sale are typically less than one-half of one percent (1/2%) of our balance sheet.

Recommendation: We recommend a risk-weight for loans held for sale at 25%.

Member Business Loans (MBLs)

Proposal: The Risk-Based Capital proposal sets the risk-weights to correspond with the percent of assets in MBLs held by the credit union as follows:

- MBL up to 15% of assets are weighted at 100 percent;
- MBL between 15% and 25% are weighted at 150 percent; and
- MBLs over 25% are weighted at 200 percent.

Comments: Approximately two years ago, AmHFCU was classified with a low-income designation serving the needs of the county of Philadelphia, the fifth largest city and the fourth largest metropolitan area within the United States. As a result, we are exempted from the aggregate loan limit for MBL's. As such, it is our belief that being designated as a low-income credit union meant that the government wanted us to lend to our marketplace and reinvigorate the economic area we serve. The proposed risk-weights will restrict that goal. We agree that if we go over the traditional

12.25% of assets that we will have concentration risk, however, we are receiving mixed messages. Furthermore, credit unions chartered for business loan purposes should be given a different set of risk-weights that doesn't require them to abandon their core mission for their membership. The risks to the portfolios of these special credit unions, including concentration risk, should be managed through the examination and supervision process, not through these capital risk-weights.

Risk-weights should also be broken down for types of loans such as agricultural MBLs or commercial real estate MBLs and given appropriate risk-weights based on their actual risk.

Unlike the investments above, the risk-weights for MBLs do not take into consideration the various maturities or repricing terms. A 15 year non-delinquent fixed rate MBL carries the same risk-weight as a 5 by 5 year adjustable rate MBL. Non-delinquent MBL loans should incorporate repricing characteristics.

The risk-weights also do not take into consideration any of the following factors that could indicate that the loans are more or less likely to be collected and which are more stringent than banking financial institutions must conform to, including

- the loan-to-value ratio of loans, or
- the personal guarantees of member-borrowers, or
- experience requirements of MBL underwriting contained in Part 723.

These factors should be used to lower the amount of capital required to be held for loans that are safer than others. Since it will be difficult to capture the above factors into a credit-union wide capital standard, using remaining maturity will imply some of these attributes. As a MBL repays and the LTV decreases during normal times, such MBL becomes significantly less risky. The remaining term to maturity or reprice date is the best, unique factor that incorporates some of the items that would not otherwise be able to be captured on a call report.

Furthermore, the proposal does not incorporate any risk mitigation efforts. At American Heritage Federal Credit Union, we mitigate interest rate risk by borrowing advances from the Federal Home Loan Bank in a matched-book strategy. For our approximate $125 million commercial- mortgage portfolio with a 5 year repricing structure and $10 million commercial mortgage portfolio with a 10 year structure, we have pledged $50 million towards advances that could be drawn down against in order to mitigate interest rate risk. This is not apparent by concentrating the risk based capital calculation solely on assets. We have not begun to incorporate risk mitigation efforts through the use of derivatives, and at this time, not certain that we will deviate from our traditional hedging strategy, but derivative will play a role in the industry going forward. Therefore, risk mitigation efforts should be included.

Recommendation: Overall, we recommend different risk categories for concentrations in MBLs that incorporate maturity/repricing information and on-balance sheet hedging strategies, as follows:

For MBLs, net of hedging balances, up to 15% of assets, the following risk-weights:

- For MBL with 00-05 year maturity/reprice, the proposed risk-weight is 10 percent.
- For MBL with 05-10 year maturity/reprice, the proposed risk-weight is 20 percent.

- For MBL with 10-15 year maturity/reprice, the proposed risk-weight is 40 percent.
- For MBL with 15-20 year maturity/reprice, the proposed risk-weight is 60 percent.
- For MBL with 20-25 year maturity/reprice, the proposed risk-weight is 80 percent.
- For MBL with 25-30 year maturity/reprice, the proposed risk-weight is 100 percent.

For MBLs, net of hedging balances, between 15% and 25%, increase the weights by 25% as follows:

- For MBL with 00-05 year maturity/reprice, the proposed risk-weight is 35 percent.
- For MBL with 05-10 year maturity/reprice, the proposed risk-weight is 45 percent.
- For MBL with 10-15 year maturity/reprice, the proposed risk-weight is 65 percent.
- For MBL with 15-20 year maturity/reprice, the proposed risk-weight is 85 percent.
- For MBL with 20-25 year maturity/reprice, the proposed risk-weight is 105 percent.
- For MBL with 25-30 year maturity/reprice, the proposed risk-weight is 125 percent.

For MBLs, net of hedging balances, over 25%, increase the weights by 25% as follows:

- For MBL with 00-05 year maturity/reprice, the proposed risk-weight is 60 percent.
- For MBL with 05-10 year maturity/reprice, the proposed risk-weight is 70 percent.
- For MBL with 10-15 year maturity/reprice, the proposed risk-weight is 90 percent.
- For MBL with 15-20 year maturity/reprice, the proposed risk-weight is 110 percent.
- For MBL with 20-25 year maturity/reprice, the proposed risk-weight is 130 percent.
- For MBL with 25-30 year maturity/reprice, the proposed risk-weight is 150 percent.

CUSOs

Proposal: The proposal would set the risk-weight at 250 percent for an investment in a CUSO and 100 percent for loans to a CUSO.

Comments: We understand that a CUSO is an unsecured equity investment with no secondary market but the proposal would suggest that an investment is 2.5 times more risky than a loan to a CUSO. If a CUSO was not making money, then the investment and the loan are equally at risk. We have an ownership interest in ten CUSOs, seven of which are managed by others and three of which are managed by ourselves. There was another investment in a CUSO that we had that we wrote off due to obsolescent technology. When a CUSO fails, both the investment and loan are equally at risk, so we believe the loan and investment should have equal weighting.

When a CUSO is managed well, both the investment and loan have no increased risk over and above the activity remaining within the Credit Union. This proposal by itself implies that CUSOs are more risky than those same functions performed within the credit union. The CUSOs we manage are able to hire experts in the field of the business that we would not otherwise be able to hire if each of the credit union owners were each hiring experts. In our circumstances, we hired 1 expert instead of 12 experts within a confined geographic area for commercial lending, and 1 expert within the commonwealth of PA instead of 60 experts within the mortgage arena. These experts concentrate on the rules and regulations within their discipline and build relationships that we otherwise would not be able to achieve. We view CUSOs as less risky based on the experts hired to run the operations.

There were a couple of high profile credit union losses partially driven by bad CUSO investments. The reality remains that the overwhelming majority of CUSOs are performing very well, generating considerable savings through economies of scale and providing much needed non-interest income to their credit union owners. The CUSOs we manage have generated positive earnings for many years and have enabled us and 10-15 other credit union owners to save significant costs in hiring experts to run specialized operations.

The proposal groups all CUSOs equally. There are operational CUSOs intended to pool resources to reduce operational costs, similar to the cooperative business model. There are fee generating CUSOs that generate fee income by marketing a product to a credit union's members. There are loan origination CUSOs that underwrite and possibly originate and fund business loans, mortgage loans, credit card loans and other loans. All have separate business plans with different business strategies.

Less than 22 basis points of credit union assets are invested in CUSOs and don't represent a systematic risk that could take down the share insurance fund.

Recommendation: We recommend that the investment in a CUSO and a loan to a CUSO be equally weighted. We further recommend that such weighting be at 75 percent due to the expertise that is brought to the business strategy within the relevant business model that they are operating within.

Mortgage Servicing Assets

Proposal: The proposal would set the risk-weight at 250 percent for mortgage servicing assets.

Comment: Servicing rights are established when the sale of an asset occurs and servicing is retained, regardless of whether it is a mortgage or not. We also establish servicing rights when we participate commercial loans, automobile loans, etc. We believe that the actual intent of this area is servicing rights in general, not just mortgage servicing rights.

Mortgage servicing rights are traded between financial institutions in an active market. When we sell or participate a loan, we establish mortgage servicing rights equal to our estimation of the present value of future servicing income, subject to a limit of the current active market pricing. And depending on the accounting, a credit union could be subject to accounting adjustments either monthly or annually. If a credit union wants to use mark-to-market accounting, the adjustments would be made monthly, or if a credit union wants to use lower of cost or market accounting, the adjustments, if any, would be made annually when a valuation is performed by a third party. In either scenario, mortgage servicing assets are marked to market at least annually. Therefore, we do not recognize the significant risk in mortgage servicing assets over and above what the market itself is indicating to us and which we must report on the quarterly call report.

In addition, last year NCUA finalized a rule on loan participations that was intended to help credit unions and NCUA better manage the potential concentration risk in loan participations. The loan participation rule is working and should be allowed to continue working instead of higher risk- weights for mortgage servicing assets.

The other factor that can be considered is whether the sale or participation was performed on a recourse or non-recourse basis and increase the risk-weighting if the loans are sold with recourse and are serviced by the credit union.

Recommendation: We recommend a 100 percent risk-weighting for servicing rights on assets sold without recourse and 150 percent risk-weighting for servicing rights on assets sold with recourse, as such valuation on the financial institution is performed at least annually by experts who value such assets regularly.

Corporate Paid-In Capital

Proposal: The Risk-Based Capital proposal would set a risk-weight for paid-in corporate capital at 200 percent.

Comments: The corporate credit unions have had more regulatory changes over the past five years than any other sector of the credit union system including additional capital requirements, more strict investment limits, concentration risk prohibitions, and governance changes. These previous regulatory changes to the corporate credit union system and the risks they have eliminated should be represented in a lower risk-weight.

The proposed risk-weight does not reflect the actual risk of this asset. The Risk-Based Capital proposal suggests that corporate paid-in capital is two times as risky as a dollar invested in a mortgage loan in excess of 35% of assets. This could serve as a disincentive to credit unions to invest in corporate credit unions.

Recommendation: We recommend paid-in capital should be more appropriately weighted at 125 percent to recognize that the corporate credit union structure is different from what it once was, and now presents less risk to the credit union system. 125 percent also recognizes that the paid-in capital corporate is more risky than safer investments such as treasuries or consumer loans, but less risky than delinquent loans.

Numerator Adjustments-Goodwill, NCUSIF Deposit, Intangible Assets

Proposal: The Risk-Based Capital proposal would subtract a number of components from the numerator portion of the risk-based capital ratio that are currently present in the risk-based capital numerator. They include goodwill, the NCUSIF deposit, other intangible assets, and identified losses not reflected as adjustments to components of the risk-based numerator.

Comments: We do not have any goodwill on our balance sheet, but the loss of goodwill within the risk-based capital ratio numerator penalizes credit unions for their past actions and can present significant problems in the future. For those credit unions that have merged with or assumed a credit union, goodwill is most likely present on the balance sheet. This Risk-Based Capital proposal could remove the benefit that credit unions recently involved in mergers currently account for. For those credit union thinking of merging in the future, a healthy credit union is less likely to agree to take on a troubled credit union as a partner (even at the request of NCUA). This is going to make it harder and more expensive for NCUA (and the industry as a whole) to find merger partners for troubled or failing credit unions which will ultimately lead to more expensive liquidations for the Share Insurance Fund.

Recommendation: We recommend that goodwill should be added back into the numerator of the risk-based capital ratio.

Supplemental Capital

Proposal: The Risk-Based Capital proposal does not provide any changes that would allow credit unions the authority to raise supplemental capital.

Comments: Currently, a credit union's net worth ratio is determined solely on the basis of retained earnings as a percentage of total assets. Because retained earnings often cannot keep pace with asset growth, otherwise healthy growth - such as growth resulting from taking deposits - can dilute a credit union's regulatory capital ratio and trigger non-discretionary supervisory actions under prompt corrective action (PCA) rules. Allowing eligible credit unions access to supplemental capital, in addition to retained earning sources, will help ensure healthy credit unions can achieve manageable asset growth and continue to serve their member-owners efficiently.

Supplemental capital authority is needed now more than ever considering the restrictions brought on by this rule. NCUA should call on Congress to pass a legislation solution that modernizes capital standards to allow supplemental capital and directs the NCUA Board to design a risk-based capital policy for credit unions that takes into account material risks instead of the current Risk-Based Capital proposal.

While supplemental capital authority is important for those credit unions that are able to raise it, it is important to understand that supplemental capital authority it not the answer to all of our woes. There is a difference between the authority to raise supplemental capital and the ability of individual credit unions to actually do so. Not every credit union would be able to use that important tool to actually raise significant capital even if they were given the authority to do so.

Recommendation: We recommend that supplemental capital authority be incorporated into the risk-based capital proposal.

Individual Minimum Capital Requirement

Proposal: The Risk-Based Capital proposal § 703.105 provides NCUA the ability to require a higher minimum risk-based capital ratio for an individual credit union in any case where NCUA determines that 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. This means that NCUA may establish increased individual minimum capital requirements upon its determination that the credit union's capital is or may become inadequate in light of the credit union's circumstances regardless of the actual risk-based capital ratio of the credit union.

Comments: On one hand, the NCUA is saying that the risk-weights are designed specifically to factor in a number of risks including concentration risk, interest rate risk, credit risk, market risk, operational risk, and liquidity risk. On the other hand, if the NCUA decides that their risk-based capital ratios don't do what they are designed to do, then the NCUA can just change the rules for an individual credit union. How are credit unions supposed to make business decisions about their portfolio and adhere to the standards laid out in the proposal with a constantly moving set of rules?

Recommendation: We recommend this section be removed from any final rule.

Call report preparation

Comments: As a preparer of the quarterly call report and then as a reviewer, it is difficult to recognize the MBLs and commercial deposits within a credit union. The current call report's loan and share sections are categorized by collateral without incorporating the type of borrower or source. In addition, MBLs are typically on a different computer system than a credit union's consumer loan portfolio. Therefore, mechanical errors can exist as different systems are combined and reported on the call report within one table on page 2. Because consumer loans and MBLs are typically on two different systems, it would be easier to provide the same detail for MBLs as we currently do for consumer loans. It would also be easier for the reader of call reports to understand the amount of business coming from MBLs and consumer products.

Recommendation: We recommend that the loan and share section within the call report be first sorted by consumer and commercial, and then by collateral. Page 2 would look similar to the below with a comparable separation for shares on page 3:

Consumer Loans:

- Unsecured Credit Card Loans
- All Other Secured Loans/Lines of Credit
- STS
- Non-Federally Guaranteed Student Loans
- New Vehicle Loans
- Used Vehicle Loans
- First Mortgage Real Estate Loans/Lines
- Total Other Real Estate Loans/Lines
- Leases Receivable
- Total All Other Loans/Lines

Commercial Loans:

- Unsecured Credit Card Loans
- All Other Secured Loans/Lines of Credit
- New Vehicle Loans
- Used Vehicle Loans
- First Mortgage Real Estate Loans/Lines
- Total Other Real Estate Loans/Lines
- Leases Receivable
- Total All Other Loans/Lines

Total All Other Loans/Lines

Implementation Period

Proposal: The Risk-Based Capital proposal has an implementation time period of 18 months after the passage of a final rule and its publication in the Federal Register.

Comments: The proposed 18 month implementation timetable is not long enough for a rule with such broad impacts. The net-worth and capital requirements necessary to be both a safe and sound financial institution could vastly affect a credit union's decision making. It will take time for credit unions to adjust their balance sheets related to this new regulation. That doesn't include the changes that need to be made to internal systems and operations, well in advance of the effective date.

Most credit unions are not allowed or able to raise supplemental capital to instantly raise and improve their risk-based capital ratios. Credit unions need a longer amount of time than banks to save and capture retained earnings. This would be more consistent with the time frame given the banking industry during the BASEL standards implementation.

Any implementation period should be no less than three years after passage of any final rule. Credit unions will need at least that long to make safe and sound decisions about potential fundamental changes to their core business decisions including investments and product offerings. A three year implementation period more appropriately compares to the time frames given to the banking industry by their regulators during the implementation of the BASEL standards.

Recommendation: We recommend an implementation period of at least 3 years from the passage of any final rule in order to give credit unions enough time to raise capital through retained earnings or make necessary changes in their operations.

In conclusion, adopting our recommendations will reestablish AmHFCU's well-capitalized buffer to approximately $32,835,000 from our current $34,762,000 buffer and the NCUA's risk-based capital proposal's buffer of $341,000. This will allow management to continue to grow our business and serve our members in the fifth largest city and fourth largest metropolitan area in the United States.

I thank you for the opportunity to express our comments and hope you will seriously consider our recommendations prior to rendering the final rule on this complex and extremely important matter for our industry. Our ongoing viability as an industry is in your hands.

Sincerely,

Bruce K. Foulke
President/CEO