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May 19, 2014

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

Subject: Comments on NCUA's Proposed PCA-Risk-Based Capital Rule

Dear Mr. Poliquin:

On behalf of Motorola Employees Credit Union (MECU), we appreciate the opportunity to provide constructive feedback to the National Credit Union Administration (NCUA) regarding its proposed Prompt Corrective Action - Risk-Based Capital rule. Generally, we commend the NCUA's efforts to revise capital requirements within the credit union industry. However, there are certain aspects within the proposal that would likely put the industry, and MECU, at a competitive disadvantage. Ultimately our members will be negatively affected.

Following, we address several aspects that we believe should be amended.

Capitalization:

- The proposal requires a well-capitalized credit union to maintain a 7% net worth ratio (unchanged from the current PCA system) and a new 10.5% risk based capital (RBC) ratio. However an adequately-capitalized credit union (defined as a credit union with a net worth ratio of 6.0%) requires an 8.0% RBC ratio. In other words, the RBC ratio for well-capitalized credit unions exceeds that for adequately capitalized credit unions. It appears to be illogical that a credit union with a higher net worth is penalized with a higher RBC requirement than a credit union with a lower net worth.

- Credit unions will have to maintain higher net worth and RBC requirements than the banks' Basel III requirements despite credit unions' regulatory restriction of being unable to raise capital in any way other than earnings. The higher requirements serve to exacerbate the difficulty that credit unions currently face when competing with banks.

- The proposal suggests that the NCUA may require a higher minimum risk-based capital ratio for an individual credit union on a case-by-case basis where 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. We disagree with the proposal's position of providing for an individual minimum capital requirement. We believe that the authority to require additional capital under individual circumstances already exists through the NCUA's current enforcement processes. Adding an additional layer of potentially arbitrary constraints on top of the existing minimum capital guidelines would create confusion and inconsistency in the application of the agency's standardized framework. Arbitrary examiner subjectivity should not be included in the proposal.

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Operational Effect on Credit Unions:

We don't believe that a standardized capital ratio is an appropriate and effective measure to mitigate such a broad range of potential risks including credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk. The attempt to capture these risks with individual risk-weights could create negative incentives for appropriate risk taking. We believe the proposal oversimplifies the control mechanisms for these risks and creates a framework that increases focus on certain types of risk at the expense of others. For example, the risk-weight categories in particular appear to create incentives for institutions to reduce interest rate risk while substantially increasing credit risk. Those same risk weights also seem to ignore market liquidity factors applicable to investments, and provide incentives for institutions to purchase lower-yielding securities that would reduce earnings significantly over time.

- The proposal is clearly focused on preventing risks, but it is silent on the need for credit unions to meet member demands. Requiring higher levels of capital and reducing balance sheet risks might mitigate some potential failures, but these requirements could also limit potential growth opportunities for individual credit unions and weaken the ability of credit unions to serve member needs. The discussion on risk weights that follows illustrates some examples where credit union and member needs may not be met.

Risk Weights:

While a risk-weighted capital system could be crafted to cause minimal change to credit unions' net worth requirements, the proposed rule will have a very detrimental effect on credit union balance sheets and adversely affect member services.

- The proposal sets higher risk weights and therefore higher capital requirements for credit unions with higher concentrations of assets in real estate loans, member business loans, longer-term investments and some other assets. They exceed Basel III risk weights for similar assets and place credit unions at a competitive disadvantage to banks. As such, we believe that the NCUA should adopt guidelines that are more consistent with the risk weight guidelines that are established by Basel III.

- A number of the risk weightings, especially for member business loan and mortgage concentrations as well as for CUSO investments, do not appear to be properly calibrated for credit unions. Using higher risk weights on long-term assets to deal with interest-rate risk is short-sighted without considering liability maturities.

- All of the non-investment risk categories, with the exception of non-delinquent consumer loans, have the same or significantly greater weights than the standardized risk-weights under Basel III. There is no clear explanation provided as to how these risk weights are derived, nor why they are so different from the corresponding risk weights assigned under Basel III. If the NCUA believes that credit unions should engage in certain types of lending activities, it should suggest those activities through restrictive mechanisms outside of the regulatory capital process. We believe that the capital calculation should be exclusively employed to accurately reflect the inherent risk to the institution's capital base in light of the actual risk that exists within each asset category. Additionally, as proposed, the differences between the Basel III framework and NCUA proposed framework would create significant disparities between the relative capital requirements of the two industries. As such, we believe that the NCUA should adopt guidelines that are more consistent with the risk weight guidelines that are established by Basel III.

- At best, the proposal assigns risk weights inconsistently and arbitrarily across different investment and other asset classes. One example is a 0% risk-weight being assigned to investments issued and guaranteed by the U.S. Government, without regard to their weighted average life and therefore ignoring interest rate risk. However a high quality GSE pass-through security with an average life of >5 years and <10 years, receives a 150% risk-weight. Another example is that an individual 30-year mortgage would receive a standard risk weight of 50%. If the loan became delinquent, it would then receive a risk-weight of 100%, still below the high-quality GSE investment. The implied assumption behind this risk-weight disparity is that the GSE investment represents a much greater risk to capital than the non-guaranteed, single-obligor 30-year mortgage. In reality, the GSE has a shorter maturity and is more marketable and liquid than the individual mortgage. This appears to be recognized under Basel III guidelines, where the GSE would carry a risk-weight of just 20%.

- Deducting the NCUSIF deposit suggests that the deposit is worthless and has no real insulating impact on capital. We believe that the deposit is a real deposit for accounting purposes that can be returned in the event of a merger or conversion. Subtracting the deposit from both the capital and risk-weighted asset totals is equivalent to writing off the deposit. We are concerned that it becomes more difficult to prove the asset has future economic value when it has no value in the regulatory capital ratio calculation.

- The proposal does not provide the statistical data that was used to support the increased risk weights for the asset concentration percentages. It would be helpful for credit unions to have access to the data to properly assess the risk and allow for appropriate balance sheet decisioning.

Specific Risk Weight Recommendations:

- The risk weight for cash on deposit at the Federal Reserve Bank should be 0%. Since the Federal Reserve is one of the NCUA-designated sources for emergency liquidity, its safety and soundness should be similar to that of the government agencies. Also, the risk weight of overnight funds (cash) is set at 0%.

- For securities, the 0% risk weight for U.S. Treasuries, regardless of the weighted-average life, ignores any interest rate risk and is lower than the 20% risk-weight for cash on deposit at the Federal Reserve Bank.

- For securities issued by U.S. Agencies, the risk weights range from 30% to 170% higher for investments that have weighted-average lives >1 year to >10 years respectively than Basel III. Risk weights should be the same as those assigned for the securities purchased by banks.

- The 1,250% risk-weight category for an asset-backed investment for which the credit union is unable to demonstrate a comprehensive understanding of the features implies a loss greater than 100% of the principal.

- Share-secured loans have a risk weight of 75%, but since we have access to the collateral, these loans should have a risk weight of 0%.

- Applying a 250% risk-weight to an investment in a CUSO would result in the unintended consequence of restricting investments in CUSOs due to the punitive risk weighting. Additionally, many CUSOs are highly successful and owners of those CUSOs will be penalized

for growing investments in profitable CUSO entities. At a minimum, there should be a lower-tiered risk weighting depending on the success and longevity of a CUSO.

- The risk weights assigned to member business loans are too severe, given the restriction on the percentage of member business loans compared to assets. As with the CUSO comments above, we feel the MBL restrictions could have the unintended consequence of restricting growth in this asset class.

- We believe that increased risk-based capital requirements for higher concentrations of residential mortgage loans are too high, and exceed the capital requirements specified for small banks in Basel III. For example, residential mortgage loans that exceed 35% of assets have a risk-weight of 100% in the NCUA proposal versus 50% in Basel III. A number of factors (type of loan, LTV, debt-to-income, etc.) influence the risk of a loan, and a broad brush approach to risk weighting mortgages seems short-sighted.

Mortgage Servicing Rights:

- We feel that the risk weighting for mortgage servicing rights is too high because the interest rate risk benefit for rising rates from mortgage servicing rights is not given any credit. When interest rates increase, so does the value of mortgage servicing rights. Interest rate risk on the balance sheet is therefore mitigated. Regardless of the accounting treatment (lower of cost or market vs. market value), the interest rate risk modeling should recognize the change in market value for the mortgage servicing rights. The risk weight should be lowered from 250% to the current 75%.

Allowance for Loan Loss Limitation:

- We disagree with the proposed rule limiting the allowance for loan losses in the numerator calculation to no more than 1.25% of risk assets. The ceiling seems arbitrary at best, and given likely accounting rule changes in estimating the allowance, credit unions will be unfairly penalized. Currently, credit unions are appropriately funding the allowance to account for potential losses. The proposal will encourage credit unions to accelerate writing off a loan rather than work with the stressed member in order to reduce delinquency, therefore reducing earnings, to meet the ceiling.

Longer Average Life Liabilities Benefit:

- Although the longer weighted average life of assets gets a higher risk weight, having longer average life liabilities does not get any reduction in the risk based capital calculation. Both sides of the balance sheet need to be appropriately calibrated and accounted for.

Interest Rate Risk Benefits from Derivatives:

- For derivatives, only the counterparty risk is used in the risk-based capital calculations but there is no benefit for reducing the corresponding interest rate risk.

Mergers/Goodwill:

- The proposed capital levels and weightings will likely hamper merger activity and discourage healthy, well capitalized credit unions from engaging in mergers with undercapitalized credit

unions since, for example, the proposal forces credit unions into less profitable asset growth. Additionally, the exclusion of goodwill from risk-based capital creates disincentives regarding merger activity. Merger activity ultimately lowers the risk to the NCUSIF by combining unhealthy credit unions with stronger ones.

Restriction of Dividend Payments:

- The prohibiting or restriction of dividend payments in any circumstance should be removed from the rule. We believe this suggestion crosses the line of regulation and into management.

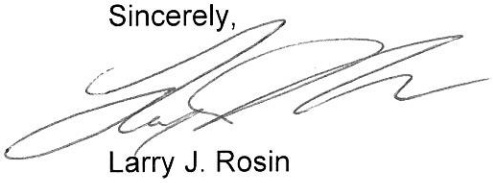
Implementation Timeline:

- The NCUA has proposed an implementation period of 18 months. Much more time would be needed to implement the sweeping changes and the recovery of the well-capitalized buffer. Bank regulatory agencies have provided small banks with an 8-year implementation period to completely conform to their Basel-based risk-weighted asset requirement. A similar timeframe would be reasonable.

In summary, the proposal's attempt to control a broad range of risks through the weighted average life thresholds on investments appears arbitrary and notably inconsistent with the longstanding capital framework that exists within the banking industry. We recommend that the risk weights for all assets be consistently applied based on the inherent risks that the individual asset classes pose to the credit union's capital structure. Without understanding how the NCUA's risk tolerances might translate into additional capital, fueled by the lack of transparency regarding the statistical data used in establishing these tolerances, credit unions will be forced to forgo appropriate risk-taking as a defensive posture against arbitrary and intermittent rule making. We suggest that Basel III provides reasonable guidelines for these risk allocations. These selective risk weights create an operationally constraining environment that would restrict a credit union's ability to supplement income and provide greater support to its capital base, and compete in the marketplace.

Thank you for the opportunity to comment on the proposed rule and for considering our views on risk-based capital requirements. If you have any questions, please feel free to contact me.

Sincerely,



Larry J. Rosin
Executive Vice President/Chief Financial Officer