From:	Evan Clark
To:	_Regulatory Comments
Subject:	Evan Clark -Comments on Proposed Rule: PCA-Risk-Based Capital
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May 27, 2014

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

Re: NCUA's New Risk Based Capital Proposal

Dear Mr. Poliquin,

Thank you for this opportunity to comment on the proposed rule regarding risk based capital. I am writing on behalf of the Board of Directors and the senior management of the Department of Commerce Federal Credit Union.

I applaud the NCUA for its efforts to reform the capital regulations. I believe that the system the NCUA is proposing is a solid one but that it definitely needs some fine tuning. And although capital is such a critical part of every credit union's balance sheet no matter how high the capital ratio of a credit union is it can never take the place of proper management of the credit union by the Board of Directors of the credit union and its senior staff. This includes a clear understanding of asset-liability management principles and a vigorous ALCO process. Below are listed my concerns with the proposed regulation.

Concerns:

1. Field examiners should not have the ability to change a credit union's capital designation. Although most field examiners are well trained they are oftentimes the persons at the NCUA with the least amount of practical experience. Credit unions should not have to manage their balance sheets with the thought that their regulators could downgrade their capital positions. The NCUA should never have the ability to downgrade a credit union's capital position. If the NCUA believes that changes are needed by a credit union these changes should be addressed in either a Document of Resolution or a Letter of Understanding and Agreement not by reclassifying its capital rating.

2. Concentration risk should also include concentration in no risk investments. If a credit union with assets greater than $50 million had a substantial investment portfolio and the extent of their investments were Treasury bonds with an average maturity of say three years they could potentially pose more of a risk to the insurance fund than a credit union with a complex balance sheet. Why? Because the credit union with the Treasuries in their portfolio may not have enough interest or credit risk in their balance sheet to maintain profitability, particularly in a low rate

environment like we are currently in.

3. Table six in the proposed rules outlines the Risk –Weight Categories and Associated Risk-Weights. Several of the risk weights are somewhat perplexing. In particular is the risk weighting of mortgage servicing assets. There are certain warranties that go with mortgage servicing rights. Once those warranties have expired then one of the few ways that a mortgage loan can be returned to the originator of the loan is if there was fraud involved in the underwriting of the loan. What the NCUA should do is classify mortgage servicing assets as under warranty and not under warranty and differentiate the risk weighting on them as such. In the commentary on this mortgage servicing assets the proposed rules state, "MSA's can become impaired when interest rates fall and borrowers refinance or prepay their mortgage loans. This impairment can lead to earnings volatility and erosion of capital. Additional risks include those associated with valuation and modeling processes." This statement makes me wonder why MSA's have to have a risk weighting of 250% when the most a credit union can possibly lose on the MSA's is the value of the MSA's themselves after the warranty period expires. Also, valuation and modeling are not risks; they are processes that a credit union with MSA's on their books should be doing on a regular basis as part of their normal asset-liability modeling. Bottom line, the NCUA needs to change its risk weighting on MSA's. For many credit unions MSA's generate a large amount of revenue for them. The proposed risk weighting could impair that ability to generate income because the amount of capital required to maintain MSA's would be so egregious.

4. Another category that seems perplexing is cash on deposit. Why would cash on deposit at the Federal Reserve have a risk weighting of 20%? What is the risk here? I believe that deposits at the Federal Reserve should have a risk weighting of zero.

5. Why do delinquent consumer loans have a risk weighting of 150%? Here again is an example of an asset class where the exposure to the credit union is limited to the balance of the loan. At most the risk weighting should be 100%. The verbiage used in the proposed rules state, "The higher risk-weight on past due exposures ensures sufficient regulatory capital for the increased probability of unexpected losses on these exposures. The higher risk-weights better capture the risk associated with the impaired credit quality of these exposures." Increased probability? Unexpected losses? What losses beyond the 100%? What increased probability? And the statement that the ALLL is intended to cover estimated, incurred losses as of the balance sheet date is incorrect. According to GAAP the ALLL is made up of two pieces. One is the estimated, incurred losses, that is correct. The other piece is on the unexpected future losses. This piece of the allowance is calculated based on the historic losses in the various components of a credit union's loan portfolio.

6. Why is the risk weighting of investment with weighted average lives greater than three years, but less than or equal to five years higher than the risk weighting of the first 25% of first mortgage real estate loans? There is credit risk in the mortgage loans and if the loan has a term greater than 10 years then it probably has an average life greater than five years. Why is that risk less that the risk in the aforementioned investments? The same comment applies to investments between

three and five years. Again, there is greater credit and interest rate risk in fixed term mortgages.

My final comment has to do with the scope of this proposal. It's an asset based proposal and does not take into consideration any of the risk reducing characteristics of a credit union's liabilities. If a credit union has a well constructed member certificate ladder the longer term certificates can mitigate much of the interest rate risk of longer term member mortgages. If a credit union has large core deposits such as regular shares or share draft accounts these liabilities act much like capital in that they can cushion a credit union from interest rate increases because typically these accounts have very low interest rates and credit unions typically keep the rates on these accounts low even in a rising rate environment. None of these liabilities are considered in this proposal. All of them have a very positive impact on a credit union's ability to manage interest rate risk.

Thanks again to the NCUA for its efforts in coming up with sensible capital requirements to replace the antiquated rules currently in place. I am hopeful that my comments and those of other respondents are useful in making the changes necessary to make this rule fair and equitable for all credit unions.

Sincerely,
Evan Clark
CEO,
Department of Commerce Federal Credit Union

Evan Clark
President/CEO
Department of Commerce Federal Credit Union
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Live well. Below your means.