Farmers Insurance Group
Federal Credit Union

May 23, 2014

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

RE: Comments on Proposed Rule: PCA – Risk-Based Capital

Dear Mr. Poliquin:

I am writing on behalf of Farmers Insurance Group Federal Credit Union. We have approximately 46,000 members and $645,477,000 in assets. We appreciate the opportunity to provide comments to the National Credit Union Administration (NCUA) on its proposed rule, Prompt Corrective Action - Risk-Based Capital.

The credit union industry needs an improved risk-based capital system that accurately reflects the actual risk on credit unions' balance sheets. Our credit union is concerned that the NCUA's risk based capital rule proposal does not reflect an accurate, realistic assessment of these risks.

Due to the number of headwinds facing credit unions such as a sluggish economy, growing overhead, tighter net spreads, declining interchange income rates, and potentially costly legislation, it is becoming increasingly difficult for credit unions to generate sufficient net income and build adequate capital in today's environment to satisfy the risk based capital requirements outlined in the proposal. Our credit union is aware of the danger associated with credit unions not having enough capital to cover the risks embedded in their balance sheets. However, we also have to be aware of the risk of requiring excessive capital in relation to the risk in their balance sheets.

There are material differences in the proposed capital requirements for credit unions compared to banks. Our credit union is unaware of the justification for the NCUA to impose more stringent requirements on credit unions, which ultimately penalizes our members for borrowing and saving at our credit union as opposed to banks.

The 10.5% "well capitalized" requirement in the proposal represents a significant jump from the current requirement for this classification. Even though our credit union's capital ratio is above the proposed 10.5% requirement, there is potential concern that we could run up against the limit if we continue to grow specific assets, particularly business loans, a consistently profitable endeavor for us for decades. Our Credit Union has earned a massive amount of net income from our various business loan portfolios over the decades. Were it not for our being predominantly a business lender, and grandfathered as such under CUMAA of 1998, our net worth would be paltry compared to what it now is. Our various commercial real estate Member Business Loan portfolios have garnered net income of $15.5 million over the last 12 years. In addition, our Farmers Agents' Agency Secured loan portfolio has been our principal source of revenue for decades. The capital requirements in the rule are much more restrictive and punitive than the standardized Basel III frameworks. The 10.5% requirement is inconsistent with the Basel III requirements that call for a minimum capital ratio of 8%, and adds an overly conservative buffer of 2.5% to the minimum requirement.

Our credit union has a serious concern that the proposed rule's risk weighting system is overly conservative and does not reflect the actual risk in credit unions' balance sheets. This conservatism will impact all credit unions because it will force us to make risk management decisions that ensure compliance with this inappropriate risk based capital ratio proposal rather than give credit unions an opportunity to prudently manage the risk on their balance sheets. This will be a huge detriment for historically sound, well managed credit unions.

Business loans, which represent the core of our credit union's assets, are risk rated at 100%, 150%, and 200% on the percentage of assets that these loans represent. We are assuming that business loans are given different ratings based on their percentage of assets to address concentration risk. It is worth noting that banks do not have a tiered weighting system based on percentage of assets. Instead, the concentration risk for banks is addressed through their examination and supervisory process, and not by the actual risk weight in their capital system. The regulators for the banking industry recognize that an individual business loan's risk does not change based on the number and balances of the business loan portfolio. The risk weight should be the same for all business loans and any concentration risk issues should be addressed through the examination process.

Our credit union believes that the CUSO investment risk metric of 250% in the proposal is excessive in light of the other risk ratings. For instance, delinquent consumer debt over sixty days along with delinquent unsecured credit card debt are risk rated at 150% and delinquent first mortgages are risk rated at 100%. NCUA has not made it clear as to why CUSOs' generated business is considered riskier than these other types of loans. In light of the struggle that credit unions are facing in today's environment, CUSOs have been instrumental in helping credit unions generate additional, incremental net income and hence the capital that the NCUA is seeking.

The current 7% net worth requirement for well capitalized was sufficient to sustain the credit union industry through the Great Recession, and credit unions did not require a taxpayer bailout. According to CUNA and the June 2013 Call Report data, the risk based capital rule would lead to credit unions needing to hold as much as $7.3 billion in additional capital. Also, 189 credit unions would encounter a decline in their PCA classification from "well capitalized" to "adequately capitalized" if the proposal was implemented and ten "well capitalized" credit unions would become "under-capitalized." In addition, a number of credit unions would go from being comfortably "well capitalized" under the current system to barely "well capitalized" under the new proposal.

Based on the data, this proposed capital system will have a material impact on a number of credit unions and put immediate pressure on the impacted credit unions to build up their risk based capital ratio. In an effort to get the necessary capital cushion under the new requirements, credit unions would be forced to go to their membership to get the capital by lowering dividend rates, raising loan rates, and increasing fees and service charges. This is an expensive proposition for a credit union industry that withstood the Great Recession with the current system in place.

The proposal will also potentially impact the level of investments in technology that is required for credit unions to grow and remain competitive with banks. It will also impact the growth in specific asset classes. For example, member business loans will require more capital. This will potentially temper the growth strategies of credit unions that rely on business lending to help drive their loan growth, net income, and capital growth. The rule proposal will also impact the credit unions that are comfortably "well capitalized." The rule will essentially translate to a smaller capital buffer for these credit unions.

Due to the tougher capital requirements, the topics of capital allocation and planning will consume more time during strategic planning sessions for management teams and boards of directors. In addition, capital modelling to ensure compliance with the proposal in various scenarios will require credit unions to expend additional resources in this arena. As a result, this risk based capital rule will divert the attention and resources of credit unions from other strategic issues, such as growing the business and serving our members.

There is talk that the proposal would go into effect approximately eighteen months after it is published in the Federal Register. This is unreasonable considering the new rule's long term and material impact on the strategic direction for credit unions. This timeframe would not give credit unions adequate lead time to plan for the new risk-based capital ratio requirements. Sufficient lead time is required for the credit unions that will want to restructure their balance sheets in response to the rule. The eighteen month timeframe is unfair in light of the multi-year development and implementation of Basel III for banks.

Last but not least, the proposed rule's individual minimum capital requirements also create an unsettling mood for credit unions and should be removed. The reason why is the NCUA would assume additional authority to impose even higher capital requirements on individual credit unions that could potentially exceed the already high well-capitalized level requirements. The rule gives generous deference to subjective examiner opinion. An examiner would be able to increase an individual credit union's risk based capital requirements based on the subjective portion of the examination. This creates a sense of unease and uncertainty, as examiners will have the subjective authority to change the rules of the game. Examiners, no matter how solid they are, do not understand balance sheet risk for every credit union nearly so well as credit union management does.

Thank you for the opportunity to comment on this proposed rule and for considering our credit union's view on this rule. Should you have any questions about our comments, please feel free to contact me at (323) 209-6001.

Sincerely,

Mark Herter

Mark Herter
CEO
Farmers Insurance Group Federal Credit Union