First Northern Credit Union
Leading the way
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May 27, 2014

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
177 5 Duke Street
Alexandria, VA 22314-3428

RE: PCA- Risk-Based Capital

Dear Mr. Poliquin:

On behalf of the Board of Directors, staff, and members of First Northern Credit Union, I appreciate the opportunity to comment on Proposed Rule: PCA-Risk Based Capital – RIN 3133-AD77. While we applaud the NCUA for taking steps to address this issue, we have strong reservations regarding many of the specific components of the proposal. While First Northern would still be classified as "well capitalized" under the proposed changes, we would suffer a reduced "cushion" of capital. As a result, we would be further constrained in our ability to deliver competitive products and services to our membership.

We question the need for many of the aggressively high risk weightings in the new proposal - in many cases, far more stringent than risk weightings assigned to for-profit financial institutions. We find this troubling, particularly considering that the recent financial crisis was primarily created by the same for-profit banking community being held to these lower standards. The FDIC suffered considerably more losses than did the NCUSIF over the past six years; this difference is even more pronounced when you include only natural person credit unions. These risk weightings appear to be more about controlling the competitiveness and growth potential of the credit union industry, rather than addressing safety and soundness issues.

Below, please find our comments on specific components of the proposal—

Lending—

--The recommended reserve on first mortgage loans is far above Basel 3 requirements. When first mortgages are above 25% of assets, the reserve increases to 75-100%, as compared to the Basel 3 reserve requirement of 50%. This additional reserve will limit the ability of credit unions to compete with banks and other mortgage lenders. Combine this with the uncertain future of the GSEs, and the future of mortgage lending within credit unions will become uncertain, at best. There is plenty of data demonstrating the overall high quality of mortgage lending performed by credit unions, as compared to the rest of the mortgage industry - including banks. We see no reason why we should be held to a higher capital standard than banks, especially considering that we generally produce higher quality loans.

--Also regarding mortgage lending, we believe that variable rate mortgages have different risk profiles than do fixed rate mortgages - particularly regarding interest rate risk, which seems to be the primary driver of the proposal. Their risk weightings should be lowered to reflect this difference.

--We believe that the reserve requirement on second mortgage loans is excessive. The proposed regulation requires reserve allocations of 100-150% for second mortgages, as compared to the 50% requirement of Basel 3. We understand the concept that second mortgages should be held to a higher reserve percentage than first mortgages, but requiring reserves two to three times higher than those required of for-profit banks is excessive. These standards could, in theory, make home equity lending a questionable product line for some credit unions. This would drive more of this business to the banks that created most of our recent problems, thereby hurting our members and the American economy.

-- While we understand the potential volatility in carrying mortgage servicing rights, we believe that the 250% risk weighting for mortgage servicing rights is excessive.

--The regulation as proposed does not take into account the actual credit risk inherit within each credit union's loan portfolio. We understand that this is data that is difficult to quantify. Aligning reserves based on a credit union's historical loan loss and delinquency profile could be a way to generate reasonable assumptions about a particular credit union's credit risk without needing to review instrument level data.

--The risk weights assigned to member business loans are excessive, given the percentage limits on MBLs currently in place. Requiring credit unions to reserve 150-200%, when the banking industry is only required to reserve 100%, is unfair and extreme. We believe that this could potentially restrict growth in this asset class, putting credit unions at a competitive disadvantage versus other lenders.

--Share secured loans have a risk weighting of 75%. Since we have direct access to the full amount of the collateral on the loan, the risk weighting should be much lower – perhaps even 0%.

--The reserve percentages for delinquent loans are excessive. The proposed regulation requires reserves of 150% for delinquent loans, while banks must only reserve 100%. This puts the credit unions at a distinct disadvantage, particularly when you consider that bank delinquencies aren't reportable until 90 days past due, as compared to 60 days for credit unions. It makes no sense to us why the required reserve would be so much greater that that required of for-profit institutions, particularly in cases where credit unions are following sound, conservative allowance for loan loss practices.

--Related to allowance for loan losses, we disagree with the limit of 1.25% of outstanding loans as the limit of allowance credit within the RBNW calculation. We believe that this could cause some credit unions to choose to be less conservative in their loan loss accounting, for purposes of "managing" their RBNW.

Cash and Investments—

--The risk weightings assigned to investments by the NCUA are significantly more aggressive than those assigned to banks. Investments with a weighted average life greater than one year would have a reserve percentage of 50-200%, versus the 20% risk weighting within Basel 3. This excessive reserve requirement will place credit unions in an anti-competitive position, negatively impacting our membership. Considering that a majority of credit union investments are basically free of credit risk

(Treasuries, Agency notes, and insured deposits), it makes no sense that our investment portfolios would be subject to higher capital requirements than those of banks, which are generally more aggressive, and therefore contain higher levels of risk. We understand the need to address interest rate risk within the investment portfolio, but we believe that the risk weightings assigned far exceed these potential risks.

--The current proposal does not distinguish between funds at the Federal Reserve Bank versus funds held at corporate credit unions and/or other depository institutions. The risk weight for funds on deposit at the Federal Reserve Bank should be 0%. Federal Reserve deposits are risk free, while other deposits are insured only up to $250,000.

Other Assets--

-- Removing the NCUSIF capitalization deposit from the calculation is not consistent with the concept that the deposit has actual value to the credit union. The calculation forces us to, in effect, write off the deposit. In our particular case, this forced write-off reduces our risk-based capital ratio by 133 basis points, from 13.16% to 11.83%. If this deposit has no value in the regulatory capital ratio calculation, it will become difficult to defend the notion that it has any future economic value to anyone else.

--First Northern holds an equity position in a CUSO. This CUSO provides value to our organization, and to our membership, by allowing us to provide services to our members in a more economical fashion than we could provide on our own. Its operations present very limited risk to First Northern. Our industry has many CUSO's which provide high quality service at competitive pricing for CUSO members. Requiring a 250% reserve for a CUSO investment is excessive, and it is also too "broad brush" in its thinking. Consideration should be given to the services provided, the CUSO's financial condition, and how it is utilizing our investment, to determine its risk weighting.

Another general comment -- the proposal does not address the liability side of the balance sheet at all. Interest rate risk can only be measured properly when evaluating the impact of changes in interest rates on both sides of the balance sheet. Many credit unions are employing liability strategies such as strategic borrowing, structuring their share mix, etc., specifically for risk mitigation purposes – these strategies need to be addressed within the proposed regulation.

We appreciate the opportunity to comment on this proposal. We hope that you consider our comments, and the many other comments you have received, into consideration before proceeding with the proposal. We as an industry must always remember our cooperative mission – to contribute to the financial well-being of our members. In our opinion, many components of the current proposal will move us away from that mission, and put us in an environment where profit, for purposes of meeting arbitrary capital allocations, will become our primary driver. This will make us just like any other bank – and that will not, in any way, be in the best interests of the American consumer.

James Grevenites
Controller