SERVICE FIRST
FEDERAL CREDIT UNION

NCUA Proposed Rule: Prompt Corrective Action – Risk Based Capital Comment Letter

May 27, 2014

The Honorable Gerard Poliquin
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RIN 3133-AD77

Prompt Corrective Action – Risk-Based Capital

As Controller for Service First Federal Credit Union (Sioux Falls, SD) and a credit union member, I appreciate the opportunity to comment on a rule with such industry defining implications. There is no argument that a risk based capital rule is needed inside of the credit union movement. I fully support efforts to enforce strong capital requirements, however I believe the proposed rule in its current form is not the correct path. A rule with such wide reaching effects should be deeply analyzed to be sure to uncover any potential unintended consequences.

Service First FCU is a $130MM institution serving approximately 14,000 in Sioux Falls, SD and the surrounding area. I firmly believe that the goal of any company is to maximize the wealth of its shareholders. As a not-for-profit financial institution, our shareholders are our members. We take this responsibility very seriously. Under the proposed rule, our ability to properly serve our members becomes very difficult.

Investments

The first of my concerns is that Government National Mortgage Association (GNMA) securities have been omitted from the 0% risk weight for U.S. Gov't obligations directly and unconditionally guaranteed by full faith and credit of the U.S. government. GNMA have an explicit "full faith and credit of the United State government" guarantee yet are excluded from the list. This guarantee is a major contributing factor that is considered when purchasing these types of securities for a credit union's portfolio.

Also, I do not understand the proposals indifference to an institution's liability structure. For institutions that have established longer funding positions, the institution should have the ability to lengthen its asset duration in a commensurate manner, as the resulting interest rate risk position would be minimal. These are the decisions an institution's ALM committee is created to make. The proposed calculation assumes an institution has shorter liability structures and creates a disincentive for optimization of its ALM position. This will force credit unions into shorter asset classes. With today's yield curve being so steep, this will then result in a sacrifice of current income which otherwise would assist in increasing a credit union's net worth position through retained earnings. The proposal also does not address or take into account a credit union's inability to raise supplemental capital through the issuance of capital stock.

My next investments related concern involves the overall range of risk weights across investments based on their corresponding average lives (from 20% - 200%). The proposal does not align the risk weights for investments to those applied within the banking industry (Basel 3). Given the permissible investment set, bankers wouldn't likely receive a risk weight in excess of 20%. I understand the step-up weights in the proposal were drafted to account for the increase in interest rate risk for each of the corresponding durations. Aligning the risk weights with Basel 3, would put the onus on proper interest rate risk management using tactics such as the aforementioned liability structure. This is precisely what credit union management and ALM committees are trained to do. I do not believe this is the place for a government agency to step in and mandate only one permissible strategy of investing only in shorter asset classes.

CUSOs

CUSOs across the United States are utilized on a daily bases to provide members with unmeasurable benefits. Smaller credit unions like Service First rely on CUSOs to provide products and services that they otherwise could not afford. The 250% risk weight applied to investments in CUSO would be absolutely crippling to the CUSO universe. When comparing investments in CUSOs to other uses of liquidity, potential CUSO investments will be disregarded due to the troubling amount of capital required.

Loans

Agriculture and small business are the life blood of South Dakota. South Dakota is able to operate with a surplus because of their continued success. Many of the farmers and business owners rely on their local community credit unions to provide them with much needed funding, including land loans and various operating lines of credit. With that being said, the proposal in its current form will funnel credit unions out of the business of providing these products. Many credit unions across the state exist because of the agricultural communities and farmers they serve. In many of these communities the credit union is the only financial institution in town, because banks do not find these locations "profitable." The overly conservative risk weights given to these types of loans compared to banks, will force these credit unions to consider not offering these services and possibly exiting these communities all together. Under the proposal, it may actually make sense for an agriculture based credit union to sell off its local loans (150%-200%) to big banks and purchase pools of delinquent first mortgage real estate loans (100%). This structure would simply not be sustainable.

Conclusion

These are just a few of the reasons this proposal is very scary in its current form. Credit unions across America will be asking themselves some tough questions. Do we need to reorganize our balance sheet? Can we reorganize our balance sheet in 18 months? How will we be able to build our net worth without income? How will we be able to maximize the wealth of our member shareholders?

Please consider my comments above and the proposal's effect on the credit union industry as a whole. We all take pride in coming to work every day to serve our membership. Anything hindering our ability to do so causes an almost indescribable uneasiness. Please consider the effects on credit unions of all sizes and geographic locations when issuing a final rule or updated proposed rule.

Respectfully Submitted,

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