Ann M. South
President/CEO

Novartis Federal Credit Union
One Health Plaza
East Hanover, NJ 07936

Tel 862-947-1000
Fax 973-947-1001
ASouth@NovartisFCU.org

NOVARTIS
Federal Credit Union

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

Via e-mail: regcomments@ncua.gov

May 28, 2014

I am writing on behalf of Novartis Federal Credit Union's Board of Directors, members, and staff. Novartis FCU serves the employees and the families of the Novartis Corporation in all 50 states. We have 6,000 members and $138 million 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.

We strongly believe that there is not enough justification for a rule of this magnitude. During each of the last two financial crises the FDIC fund became technically insolvent while the NCUSIF has performed very well under our current rules without taxpayer bailouts. This indicates that the current PCA system is protecting the share insurance fund sufficiently and does not need to be altered in such a dramatic and restricting form. It would serve our industry and the NCUSIF much better if the NCUA would work toward allowing supplemental forms of capital to be raised.

The proposed rule seems to be inconsistent with the NCUA's authority and responsibility under current law. We would ask that the Board review the below items carefully.

- Setting the benchmark for capital requirements at the "well-capitalized" level is not the intent of the Federal Credit Union Act. It explicitly states "adequately capitalized" in several areas.

- Many of the proposed risk-weightings are more stringent than required by the Basel III risk-weightings for small banks. Credit Unions loss ratios are typically lower than those of small banks. We fail to see the justification for higher weightings.

- Arbitrarily setting the definition of complex credit unions at $50 million goes against a directive within the Federal Credit Union Act. The NCUA is directed to consider the portfolios of credit unions' assets and liabilities when determining which credit unions meet the definition.

We do not object to additional capital requirements for some credit unions if justified by higher risks, but the risk levels should be established with a historical perspective.

PROPOSED REGULATION COMMENTS:

We are pleased to see in recent publications by the trade associations that the NCUA has indicated that there will be substantial adjustments to the proposed regulation. It does concern us that with "substantial adjustments," the credit union industry will not have the opportunity to comment again on these adjustments. First and foremost, we are asking that the NCUA once again place the adjusted regulation out for comments. This is a necessary step for the Board of NCUA to make sure that the adjustments are sufficient not to impair the industry.

RISK WEIGHTS:

Overall, we feel the risk-weights within the rule are poorly designed and are more stringent than comparable risk-weights under Basel III requirements for small banks.

Mortgage Loans: The Basel III requirements for small banks risk-weight residential mortgage loans at 50%. The proposed regulations tiers residential mortgage loans based on percentage of assets starting at 50% and increasing to 100%. The rating discrepancies are also found in the junior lien loans. In addition, all residential mortgages are risk-weighted the same, regardless of repricing features and terms. These items mentioned above, also put credit unions at a distinct disadvantage and impedes serving their fields of membership.

CUSOs Investments and Loans: Our Board of Directors believe that the CUSO investment risk metric of 250% is excessive, especially as compared to other risk ratings. Our credit union's investments in our CUSOs have consistently provided the credit union with substantial return on investments. One of our CUSOs have netted us over 25% return annually for many years, while our newest CUSO has returned an average of over 16% return in its first five years of operation. It is difficult to understand why CUSO investments that result in proven, strong earnings to their owner credit unions are arbitrarily deemed riskier.

The one-size-fits-all approach does not take into consideration many factors; such as the types of services provided, the costs associated for a credit union to provide those services in-house, history of profitability, and whether the amount invested or loaned to the CUSO is a material amount. CUSO's are a very important part of the credit union industry. Stifling collaboration and innovation within our industry can be very costly to the NCUSIF as credit unions will have to turn to outside vendors who will charge more and keep the profits out of the credit unions' reserves.

Mortgage Loan Servicing Rights: The mortgage servicing risk rating of 250% is likewise excessive, in our view. Credit unions that are affected by this regulation are also required a GAAP qualified opinion audit, which requires outside third party evaluations of MSRs that are material. We strongly encourage NCUA to reduce this risk rating significantly. There is an active market for MSRs which have established values and do not deserve a high-risk rating. Since these are market priced evaluations, they impose little or no risk to the NCUSIF. These assets, if third-party evaluated on a minimal annual basis should be rated a 0%. If not third-party evaluated, and not a material amount, these should be rated at 100%. If these assets are a material amount and not third party evaluated – then, possibly a higher percentage can be justified.

Longer-term investments: The Basel III requirements for small banks risk-weight investments at 20% regardless of their weighted average life (WAL) or maturity. The proposed regulations tiers longer-term investments based on WAL starting at 20% and increasing to 200%. This severely limits credit unions from making the best decisions on their investment portfolio ladders and their margin management.

Small Business Loans: The Basel III requirements for small banks risk-weight small business loans at 100%. The proposed regulations tiers small business loans based on percentage of assets starting at 100% and increasing to 200%. This puts credit unions at a distinct disadvantage and impedes serving their fields of membership.

TREATMENT OF THE NCUSIF 1% DEPOSIT:

NCUA's requirement that the NCUSIF 1% deposit be ignored in the risk-based capital calculation should be reconsidered. The justification for removing the deposit is unclear, yet quite significant. The impact on our credit unions' Risk Based Capital is close to a 1% difference. The agency needs to provide a deeper explanation as to its reasoning for this proposed change or remove this requirement.

APPLYING A MINIMAL CAPITAL REQUIREMENT ARBITRARILY:

While the need for flexibility within the proposed rule is understood, it is concerning that NCUA would propose an arbitrary minimal capital requirement to a credit union. That type of flexibility, in our opinion, is beyond the scope and authority of this agency and leaves a credit union vulnerable to an individual examiner's subjectivity.

SUPPLEMENTAL CAPITAL:

The introduction of a risk based capital system requires more options for all credit unions to raise supplemental capital. As stated earlier, we encourage NCUA to accelerate the efforts to implement supplemental capital options for all credit unions, in conjunction with the Risk Based Capital Rule implementation, providing an important tool for those credit unions that will no longer be well capitalized as a result of this rule and for others that need strategic options to assist them in managing the new risk based capital standards. We believe NCUA has the power to authorize supplemental capital for risk-based capital purposes and should do so concurrently with this proposed regulation.

IMPLEMENTATION DATE:

Our opinion is that the NCUA would be putting undue burden on some credit unions by the short implementation date. We have all been in a recessionary environment since 2009, and the low interest rates have taken its toll on earnings. If higher interest rates return, that will provide some relief for compressed margins, but the improved earnings, if and when that occurs, will not happen overnight. We recommend a three-year implementation period or longer.

HOW THIS EFFECTS OUR CREDIT UNION:

Our credit union's field of membership are highly educated and many are highly compensated. They have average credit scores above 780's. Typically they are not borrowers, except for mortgages. Prior to the recession we held a large percentage of mortgage loans. The credit union maintained a highly successful mortgage loan participation ladder and served our field of membership well.

Once the interest rates fell, we decided not to take on the interest rate risk associated with low interest mortgage loans and began selling these types of loans on the secondary market (through our CUSO). In the past five years, our loan to shares have decreased dramatically. This has impaired our income from operations extensively.

When applying the new RBC risk-weightings to our current portfolio, our credit union appears to be 'well capitalized.' When interest rates rise a little more, we will strategically begin to get back into the mortgage portfolio business. It is our intentions to begin holding quality mortgages again. The proposed risk-weighting will prohibit us from doing this at the same levels we were allowed to do it prior to the recession and the implementation of this proposed rule. In effect, we will not be able to serve our members with the only lending products they want and use. It will put our credit union at a distinct disadvantage and cause us to be less profitable.

IN CONCLUSION:

The Board of Directors, members, and staff are grateful for this opportunity to comment on this proposal and hope you consider our views. We hope we have the opportunity to comment on the second draft of the proposal as a 'substantially adjusted' rule needs to also be vetted properly. We are available to discuss our above comments at your convenience.

Thank you for your time and consideration.

Sincerely,

Ann M. South

Ann M. South
President/CEO
Novartis Federal Credit Union

Cc. Deborah Matz, Chairman
Michael Fryzel, Board Member
Richard Metsger, Board Member