May 28, 2014

Mr. Gerard 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:

Thank you for the opportunity to comment on the proposed changes to NCUA risk-based capital standards/requirements. On behalf of Arizona Central Credit Union, please accept this response to the proposed Risk Based Capital requirements.

Overall I agree that the current method of determining the risk based net worth (RBNW) ratio does need to be modified to be more consistent with other methodologies used in the financial industry. However, it does seem like the timing of this rule is somewhat contradictory to at least a few discussions currently taking place in the banking arena concerning how ineffective a risk based capital approach was during the last financial crisis (below).

OCC, FDIC, Fed Unanimously Adopt Simple Leverage Ratio Capital Rules

Quotes from FDIC April 8, 2014 Board meeting:

Chairman Gruenberg: "In my view this final rule (leverage ratio) may be the most significant step we have taken to reduce systemic risk."

Vice-Chair Hoenig: "The supplementary leverage ratio is a more reliable measure that is simple to calculate, understand and enforce than subjective risk-weighted measures . . . Experience has shown that relying on a risk-based capital measure serves the public poorly . . ."

Board Member Norton: "There is economic research to support the conclusion that the leverage ratio is a statistically significant predictor of banks default while the Basil Tier I risk-based capital is not . . ."

•Conclusion: Banking regulators are unanimous. The cooperative, simple leverage ratio works; risk-based capital rules do not.

Arizona Central has completed an initial analysis of the proposed risk-based rule and we have determined that we would remain well capitalized under the proposed system, but our "capital cushion" would shrink dramatically. We currently have a cushion over "well capitalized" levels equal to approximately 190 basis points of total assets.

Under the proposal, the cushion over "well capitalized" levels would decline to just 5 basis points, a loss of capital ratio cushion of approximately 185 basis points. In terms of dollars our cushion over "well capitalized" levels would shrink by a total of $7,457,125, or in other words approximately 20% of our current equity position.

CUNA estimates that if all affected credit unions were to adjust their current capital levels to maintain the current margin over "well capitalized" levels, the credit union movement would have to increase capital by approximately 8 billion dollars, during a time of extremely low margins.

Due to these potential macro effects, Arizona Central does not support the proposed risk based capital changes.

Arizona Central Credit Union has concern with many parts of the proposed risk-based capital requirements. Listed are just a few areas of the greatest concern;

ALLL - Arizona Central Credit Union believes that NCUA should consider eliminating the cap of 1.25% of risk assets in determining the numerator for the risk based ratio. There is still must uncertainty concerning the effects of the proposed accounting for credit losses recently released by FASB. It has been speculated that a credit union's ALLL could increase over 50% if the current proposal is approved by FASB. This is a substantial accounting rule change for the industry and tying further regulation to this concept could impact credit unions in a negative way even though that is not the agency intention.

Member Business Lending – Arizona Central Credit Union feels assigning higher risk weights to business loans in excess of 15% of assets has no value. As the agency is aware, the current cap for business loans is 12.25%. If a credit union files a waiver for a larger percentage, I would assume the credit union would have to exhibit to the agency that they could handle the extra business lending exposure without subjecting the NCUSIF in further risk. The risk based capital requirements should be updated in the future if a higher business lending cap is approved. Again similar to the ALLL, it seems rules/requirements are being proposed based on limits or accounting rules that are not even in place.

Investments - Arizona Central understands the effect of duration on the price volatility of investments and why NCUA is proposing higher risk weights to longer WAL investments. However, we believe that the BASEL III approach is the best when dealing with this area. First, it allows for continuity with other financial institutions regulators, and second a hypothetical credit union with a very large yet short auto loan portfolio should not be negatively impacted for owning longer average life agency mortgage securities. Overall balance sheet risk for this hypothetical credit union may not be different than another credit union however there capital requirement could be different due to the balance sheet composition. Once again, if the "government agency security" designation/label is in question due to the future uncertainty of the government agencies, Fannie Mae or Freddie Mac, then NCUA is proposing very different risk weightings than what other financial institution regulators are requiring based on the speculation concerning the future existence of the government agencies before any decision concerning their future viability has been announced. At the end of the day, a government agency security has the same credit risk regardless of WAL or duration and the BASEL III risk weights are illustrative of that. The duration risk is evaluated and managed by credit unions in other areas such as ALM modeling.

<u>Off Balance Sheet</u> -

Under the proposed risk-based capital requirements, credit unions must capitalize unfunded commitments on non-business loans and business loans. In order to improve the risk-based capital ratio a credit union may look to reduce or eliminate line of credits to consumers or small business owners. It is already difficult to provide lines of credit to small business and have these unfunded commitments go against the overall business loan cap. The factor of 10% for non-business loans is probably very workable and not so prohibitive in providing these lines to members, however the 75% factor on non-funded business commitments is much more restrictive. It is the experience of Arizona Central Credit Union that many times business lines of credit are continually drawn on and paid down and quite often the average balance outstanding on these lines is many times well below 50% of the line. Given this reality, a 50% factor may be more realistic and fair when trying to determine how to capitalize unfunded business lines.

<u>NCUA Authority to Assign Higher Limits</u> – Arizona Central Credit Union does not support the ability for NUCA, at their discretion, to impose higher risk-based capital levels. The proposed rule gives NCUA the authority to impose even higher risk-based capital requirements on a case by case basis. I am sure, as it stands today, NCUA would prefer not to use this authority or if they did it would be used it in rare instances. However, when it comes to standardized rule-making in an area such as risk based capital or when trying draft a proposal similar to what other financial institutions are subject too, this kind of "complete" authority and the ability to "raise the bar" has no purpose. Credit unions should be able to structure their business model around sound rule making and have the assurance that the "rules of the game" will not be changed on them at a later date.

Thank you for the opportunity to comment on this important proposed rule and for considering our views on the risk based capital requirements.

Sincerely,

Greg Harden

Greg Harden

SVP/Chief Financial Officer