May 27, 2014

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

Dear Mr. Poliquin:

On behalf of the Millbury Federal Credit Union (MCU) and its Board of Directors we would like to make the following comments with respect to NCUA's proposed risk based capital rule.

To paraphrase an ancient proverb "No man or woman can serve two masters". That being said, regulation should not attempt to govern both interest rate risk and credit risk within the same risk based capital model. By doing so credit unions will be forced to make decisions in balance sheet management that defy logic. Balance sheets, like huge oil tankers cannot turn on a dime. They take substantial time to be adjusted in a prudent manner.

We feel that the NCUA is fostering reputation risk with this regulation. For the last 20 years MCU has always been well capitalized, even after being assessed over 100 basis points of net worth to help clean up the well-known Corporate Credit Union issue. This regulation will arbitrarily demote MCU to adequately capitalized. If implemented as proposed, major balance sheet restructuring will be required for MCU to be reinstated with its well capitalized designation. Every shift in our mortgage assets to shorter term assets (such as auto loans) will result in a further decline in yield in an already very difficult earnings environment and therefore less net income (the only way to increase net worth!)

It is easy to discern that the NCUA is petrified of interest rate risk in the current economic environment. The agency is equipped with an army of specialists who fight that battle every day. There is no need to incorporate restrictions on assets for interest rates in what should be a credit based metric. The conceptual logic of the NCUA Capital Model is flawed in that it effectively applies weights for interest rates to only one side of the balance sheet ignoring any mitigating longer liabilities or hedges.

MCU holds a higher percentage of mortgages than the average credit union because we have long since been a community chartered credit union and this is a critical component of how we serve our membership and community. Your proposed calculations simply apply more weight to higher aggregate amounts that are booked. It's interesting that for years examiners have been beating the drum to sell fixed rate mortgages and hold adjustables, yet no distinction is made between the two in the NCUA proposal. All these years we have been giving up yield to satisfy this strong recommendation. The FDIC makes no distinction for the aggregate amount you hold

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and only applies .50 percent for credit risk. And to that point, MCU is and has been lower than peer group in delinquencies and charge-offs. We manage credit risk very closely.
The same weighting pattern applies to Other Real Estate. Second mortgages may be more risky and deserve a higher rating but does the more you hold the higher the risk you incur really apply?

The 2.50 percent weighting for CUSOS appears excessive. No attempt is made to delineate the type of function for which the CUSO performs or stratify potential risk. Overall risk is already constrained by the one percent investment and lending regulation. If the function performed by the CUSO is one which could be done by the credit union itself, then where is the excess risk? If the CUSO is wholly owned all of the risk is already reflected in the balance sheet and the investment eliminated with any residual value or loss reflected in equity.

If a credit union were to decide to sacrifice some yield for liquidity, it might securitize 30 year mortgages and take them back as securities on the balance sheet. If the average life were over five years the net worth required would be higher to support essentially the same but more liquid asset. It is clear from the weights attached to investments, which increase with maturity, that the concern of the NCUA is interest rate risk. It begs the question, is a five year US Treasury Note really more risky than a Municipal Revenue Bond?

One final thought, if the FDIC weightings were to be applied to the Millbury Federal Credit Union balance sheet the result would be Well Capitalized. It is no wonder that many credit unions are looking at the adequacy of their charters.

We at MCU urge the agency to completely reconsider the adequacy of the proposed model and the timing of its implementation.

Sincerely,

Joseph F. Barbato *Robert W. Hobson*

Joseph F. Barbato
President and CEO

Robert W. Hobson
Executive Vice President and CFO

JFB/sep

Cc: MCU Board of Directors
Dan Berger, President - NAFCU
Michael N. Lussier, Director-at-Large - NAFCU

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