SOUTHWEST MONTANA COMMUNITY FEDERAL CREDIT UNION

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May 28, 2014

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 55314-3428

Re: Prompt Corrective Action; Risk-Based Capital

Mr. Poliquin:

On behalf of Southwest Montana Community Federal Credit Union our 7,200 members, staff and Board of Directors I would like to offer the following comments on the recently proposed Risk Based Capital rule. While SWMCFCU recognizes the need for an updated rule that is well balanced and a specific set of capital standards which reflects the credit union system, we have serious concerns about the proposed rule that we feel need to be addressed.

The Federal Credit Union Act requires that the NCUA develop a RBNW requirement which accounts for the material risks that our net worth may not provide adequate protection for. These material risks could come from 9 operational risk areas – yet the proposed rule is geared only to address the agencies overwhelming fear of Interest Rate and/or Liquidity Risk, leaving the other 7 areas almost completely untouched.

NCUA's proposed rule was issued in part so that Credit Union's PCA rules would be comparable to other financial institutions supervised by the NCUA's FFIEC regulatory siblings, and NCUA is on record stating that they reviewed the BASEL accords as a baseline when they developed the rules proposed risk weights. Yet, when compared to the risk weighting by asset category, the proposed weighting for CU's assets are often 2 times that of the Basel III standards. Is our industry really that irresponsible that we need higher and more stringent controls to keep us reigned in?

In addition, there is a large degree of inconsistency in the proposed risk weighting between our asset categories – specifically between loans and investments in security instruments. As a case in point: If our CU were to securitize our existing 1st mortgage loans (swapping them for a GSE guaranteed mortgage backed security collateralized by these loans) our Interest Rate risk profile is completely unchanged, all of our credit risk for the loans has been removed and our Liquidity Risk is potentially reduced. But, the risk weighting for these same loans are increased now that they are part of a security instrument. How does this make any sense at all?

Further, as proposed, the rule contradicts existing regulations requiring sound Interest Rate and Liquidity Risk management.

- It ignores the Interest Rate risk of our loan portfolio.
- It ignores the liability side of our Balance Sheet. How can this be a good assessment of our overall risk status without some, even just a little consideration for our liabilities?
- The proposed rule discourages strong Balance Sheet risk management by substantially penalizing any portfolio that is NOT poised for a rising rate scenario.
    - What happens, when at some point in the future, we are dealing with higher rates and CU's need to manage for equally likely rising or falling rates? As the proposed rule stands the agency will have to rewrite it to keep CU's poised for rate changes up or down.
    - Any proper ALM practice should use the investment portfolio to mitigate, adjust or stabilize the overall Balance Sheet's level of Interest Rate or Liquidity Risk.

The proposed rule creates a competitive disadvantage for CU's until such time as rates do increase. CU portfolios will likely earn far less than our banking counterparts who are subject to Basel III and its less stringent weighting.

- The rule reduces our ability to effectively manage Balance Sheet risks.
- Resulting in our inability to be able to price our share and loan rates competitively to our markets.
- And, it results in the overall reduction of member services.

The proposed higher risk weighting than the Basel III provides significant disincentives to lend to small business and for residential home owners and, as proposed the rule will be implemented years before the Basel III standards are fully implemented for our banking competitors.

In many ways the proposed rule contradicts the Federal Credit Union Act.

- Not all material risks are being addressed in the rule. (IE – nothing addresses Market risk)
- All material risks for each asset category are not being addressed
    - For example, there is no consideration for the Interest Rate risk of loans
- The proposed rule encourages the acceptance of higher levels of Credit risk at the expense of less risky asset categories. A loss from Credit Risk will drain our Net Worth just as well as any Interest Rate risk loss might.
    - For example, Unsecured and Consumer loans are risk weighted more aggressively than Basel III comparable assets.

- Delinquent Real Estate Loans are weighted to require less capital than similar Agency guaranteed Mortgage Backed Securities which represent little or no credit risk.
- And, delinquent consumer loans are said to have the same risk of loss as a 5 year insured Certificate of Deposit? Really?
- Or, that a 20 year RV loan would be less risky than a GSE backed investment security of equal terms. What?

- The proposed rule does not meet the Act's requirement that it be comparable to banking rules which require greater capital for higher credit risk.

In summary, we believe that the rule, as proposed, illustrates a significant shift in how the agency wants to drive (read micromanage) the industry further. The NCUA has placed a very myopic definition of Interest Rate risk into the heart of this rule – short term is good, long term is bad – that is not appropriate for every Balance Sheet or for all economic scenarios.

Should the rule be implemented in its current form all credit unions will be forced to make a bet, becoming a money market fund with only short term assets and matching short term liabilities, which in turn puts them into a whole new risk stance, one that will not serve our memberships or our communities well.

This rule as proposed will not reduce the overall risk of the Credit Union industry. It should be significantly amended and reissued for comment or it should be withdrawn.

Sincerely,

Tom Dedman

Tom Dedman, President