north island credit union.

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; RIN 3133-AD77

Dear Mr. Poliquin,

I am writing on behalf of North Island Credit Union, a credit union that focuses on meeting the financial needs of consumers and small businesses in San Diego, Riverside and Orange Counties. We have over $1.1 billion in assets, 77,000 members, and operate 10 branches in San Diego County. We appreciate the opportunity to provide our comments to the National Credit Union Administration Board on its proposal regarding Risk-Based Capital requirements under its Prompt Corrective Action (PCA) rules.

In concept, North Island Credit Union fully supports risk-based capital for credit union and the NCUA's objective of utilizing a consistent framework implementing capital requirements for all federally insured financial institutions. However, we are very concerned about the implementation of this proposed rule that, because relative to banks, this proposal is more onerous and punitive.

Numerator Concerns

There are several issues with the numerator in the Capital calculation. We believe that limiting the allowance add back to 1.25% may be too restrictive as our ALLL exceeds the 1.25% of risk weighted assets. In addition, if the FASB should adopt the Current Expected Credit Loss Impairment Model, it is likely to increase the reserves by as much as 100% at some credit unions. Some consideration should be given to adding back the ASC 450-20 (FAS 5) reserve without limitation as the ASC 450-20 reserve is a general reserve that is currently calculated using a historical loss ratio that is applied against the non-reportable loan balances.

The logic behind subtracting the NCUSIF deposit from Capital is not clear in light of allowing for the add back of 1.25% for the allowance for loan losses. It would seem that charging off the ALLL would be more likely to occur before there would be a charge to the NCUSIF deposit, but for RBC purposes, the NCUSIF deposit is immediately charged to capital. At March 31, 2014, the impact to RBC was a reduction to Net Worth of 8.7%. While we note that the NCUSIF deposit is subtracted from the denominator, the reduction from Capital has a disproportionate impact, since it is not part of Capital in the first place especially since this is a deposit held by the NCUA to cover credit union failures. This asset is refundable to credit unions if they choose to withdraw from the fund and would be available to meet the claims of the credit union members. In addition, if a credit union grows its member share deposits, an increase to the NCUSIF deposit would be required and would dilute the risk based capital and inhibit growth of credit unions. We believe that it should not be a part of the calculation for either the numerator or the denominator.

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Denominator Concerns

The risk weighting for 1st mortgages acts like a progressive capital tax based on increasing concentration. If the percent of assets exceeds 25%, the capital requirement goes from a 50% risk weight to 75% risk weight which is a 50% increase. If the concentration exceeds 35% of total assets, the risk weight increases to 100% which is a 100% increase from the lowest risk weighting when the underlying asset is the same. Currently, under BASEL III the risk weight for 1st mortgages is 50% regardless of concentration.

Another example is the risk weighting of investments based on maturity. Many of our investments are in government backed investments that have no credit risk (except any premiums would not be guaranteed), but depending on the average life could have a higher risk weighting. This proposal attempts to manage interest rate risk by assessing a progressive capital tax on longer term investments. But because risk based capital is only focused on the asset side of the balance sheet, no consideration is given to the liability side of the balance sheet. Non-maturity deposits, borrowings and/or derivatives mitigates interest rate risk. All of the longer term investments in our portfolio are GSE backed instruments that do not have credit risk. In addition, a 30 year real estate mortgage loan on our balance sheet would be risk weighted at 50% (ignoring concentration risk) while securitizing that same loan into a 30 year FNMA security, with enhanced liquidity and no credit risk, would carry a 150% risk weighting.

Under the Proposed Rule, no distinction is made on the risk weightings assigned to mortgage loans of various maturity, repricing intervals and loan to value ratios. A 30 year fixed rate mortgage gets the same risk weight as a one year adjustable mortgage. Conversely, the FDIC methodology ignores concentration risk and assigns risk weightings based on LTV ratios and seniority of the lien, which we believe is more appropriate. A mortgage loan with an LTV of 50% should not be treated with the same risk weight as a loan with a higher LTV ratio.

The Proposed Rule assigns an onerous 250% risk weighting to total investment in CUSO's. The risk weighting that should be assigned should be based on how that business operation would be risk weighted if it were performed directly by the Credit Union. We are concerned that the inflated risk weighting on CUSO investments may hinder collaboration among credit unions at time when such collaboration is vital to the future success of the industry. Many credit unions look at CUSO relationships as a way to consolidate functions in a more efficient, less risky manner in order to reduce operating expenses/increase other income without having to make 100% investment in those operations/lines of business.

Other Concerns

We are also uncomfortable with the section regarding the Individual Minimum Capital Requirements of giving individual examiners or the agency the ability to impose additional capital requirements at their own discretion. Some of the items identified, should be reflected in the capital of the credit union if the risk of loss is accounted for under GAAP. The interest rate risk identified would require more capital based on the progressive capital requirement if there is a longer life on the underlying investments. Like any other rule, capital requirements should be objective and not subjective based on the opinion of examiners on a case-by-case basis.

Finally, we are not opposed to a risk-based capital approach, however we do not believe the proposal as it is currently written will serve North Island Credit Union's member or our industry. Credit unions came through the most recent economic downturn more favorably than banks, so it is unclear why we should be held to more onerous capital guidelines than banks. As currently computed, the number of credit unions who would not pass the new requirements may be limited, but as the economy continues to improve, loan demand will increase. Many credit unions have large amounts of liquidity that could be deployed into lending but may not be able to do so because of how their risk-based capital calculation will be impacted by deploying liquidity that has a lower risk weight to loans that have a higher risk weight.

If this proposed rule is implemented as presented, there could be a host of unintended consequences as credit unions adjust to this new methodology within a short 18-month window. For many credit unions, it may reduce the ability to serve existing members to the extent they are able to today. The proposal creates a competitive disadvantage for all credit unions, by requiring more capital to be maintained relative to a bank with the same balances sheet. We ask the NCUA Board to modify the calculation in order to meet its stated goal of imposing capital requirements consistent with those that are used by banks.

Thank you for the opportunity to comment on this proposed rule and for considering our comments on risk-based capital requirements

Sincerely,

Hudson Lee

Hudson Lee
SVP, Chief Financial Officer