STATE DEPARTMENT
FEDERAL CREDIT UNION
www.sdfcu.org

May 23, 2014

Gerard Poliquin, Secretary to the Board
National Credit Union Association
1775 Duke Street
Alexandria, Virginia 22314

Re: Comments on NCUA Prompt Corrective Action – Risk-Based Capital Proposed Rule

Dear Mr. Poliquin:

State Department Federal Credit Union (SDFCU) appreciates the opportunity to submit comments regarding the proposed Risk-Based Capital (RBC) rule. SDFCU supports the NCUA's efforts to address weaknesses in the current capital framework. We recognize the challenge the NCUA faces in developing a system that better identifies and controls risks across all affected institutions. We agree that credit unions which carry riskier assets should be required to carry more retained earnings, and that aligning capital requirements with those used by other federal banking agencies is a positive step.

General Concerns

Clarity of Guidance - Under the proposed rule, a credit union must meet both the 7% statutory net worth standard and a 10.5% risk-based capital ratio. SDFCU believes credit unions should be held to one net worth standard, determined by the RBC system. NCUA should seek a legislative change to the statutory net worth standard rather than layer a new and arguably different set of requirements on top of the current PCA system.

Unintended Consequences - The proposed regulation is guided by an expanded view of protecting the National Credit Union Insurance Fund (NCUSIF) from risks, including: Credit, Compliance, Concentration, Interest Rate, Liquidity, Market, Operational, Reputation and Strategic. We believe the proposed rule oversimplifies the control mechanisms and balancing effort already in place and creates a framework that questionably elevates one or two types of risk over others. Credit unions must take measured risk to ensure net income goals are achieved. The risk-weight categories create incentives for reducing interest rate and duration risks but potentially drive credit unions towards higher credit risk to ensure net income goals are achieved. Reducing interest rate risk at the expense of credit risk may prove catastrophic in the near-term, even in a stable and prosperous economic background.

By expanding the use of asset allocations by concentration of weighted-average life thresholds, the NCUA's attempt to capture the broader range of risk is a substantial departure from the Basel III framework utilized by federal banking agencies. It could be argued these allocations may create incentives to engage in higher aggregate risk activities in order to satisfy the new ratio requirements.

RBC Ratio Calculation Concerns

General – Many of the non-investment risk categories have greater risk-weights than under Basel III. The proposed rule provides no explanation as to how these risk-weights are derived, or why they are different from Basel III. It would be helpful for NCUA to provide transparency around its reasoning which may improve credit unions' assessment of impact and internal policy formulation.

Secured vs. Unsecured Loans - In some products, the risk-weights reflect a secured loan as being riskier than an unsecured loan. An unsecured, non-delinquent consumer loan receives a risk-weight of 75%, which is lower than the 100% weight assigned to a secured member business loan or a secured real estate loan. Furthermore, if either of these loan classes increase to over 25% of the total assets, its risk-weights increase to 150% and 200%, respectively. This upsets the balance currently struck between concentration, duration and credit risk factors in a seemingly unsafe manner, and may encourage an increase in riskier, unsecured lending.

NCUSIF Deposit – The NCUA has determined the NCUSIF deposit should be excluded from both the numerator and denominator of the RBC calculation. Deducting the NCUSIF deposit suggests the deposit has no real insulating impact on capital. Also, the impact of eliminating the deposit on a specific institution's capital structure is material. For example, SDFCU's RBC ratio is reduced by 106 basis points. We recommend you treat the NCUSIF deposit the same as in the net worth ratio calculation.

Investments – The 150% risk-weighting assigned to a six-year weighted average life Government Sponsored Pass-through Security (GSE) seems too high. The risk-weighting assigned to a 30-year mortgage is 50%. The implied assumption is the guaranteed GSE represents a greater risk to capital than the non-guaranteed 30-year mortgage. The six-year GSE has a shorter maturity and is more liquid than the individual mortgage. Basel III guidelines assign a 20% risk-weight to a GSE.

The use of average life risk-weighting assignments for investment appears to be driven by concerns over interest rate and liquidity risk. These selective risk-weights create an operationally constraining environment that could impair income. Credit unions could determine it best to take much longer extension risk within lower yielding investment sectors such as U.S. Government obligations that holds more IRR yet yield less to support earnings. We recommend the NCUA assign risk-weightings similar to those in the Basel III system.

Individual Minimum Capital Requirement Concerns

The proposal provides that the NCUA may require a higher minimum risk-based capital ratio for an individual credit union in any case where the circumstances indicate that a higher minimum RBC requirement is appropriate. It is unclear how the NCUA would quantify these risks and how potential risk-mitigating factors to control these risks would be evaluated. We believe that the authority to require additional capital under individual circumstances already exists through the current enforcement processes and therefore the individual minimum capital requirements should be removed from the proposal.

Other Recommendations

- Demonstrate a more empirically-justified system of balancing risk that incorporates all of the methods credit unions employ to offset risk. For example, recognize that variable rate investments are inherently less risky than fixed investments. Also that lower loan-to-value (LTV) ratios and higher credit scores significantly reduce risk to the NCUSIF. LTV ratios should be incorporated into the RBC calculation for assigning a risk weight to MBLs and other loans.

- Allow credit unions more time to comply with the proposed RBC rule.

We appreciate your consideration of our remarks. If you have any questions or seek clarification, please contact Randy McClintock at 703.706.5086.

On behalf of SDFCU Board of Directors and Senior Management Team,

Jan N. Roche
President/CEO