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May 27, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

RE: Comments on Proposed Rule: PCA - Risk Based Capital Regulation

Dear Mr. Poliquin,

Thank you for the opportunity to provide comments to the National Credit Union Administration (NCUA) Board concerning the proposed rule on Prompt Corrective Action (PCA) and Risk Based Capital.

Founded in 1934 by a group of local high school teachers with $4,000 in assets, Spokane Teachers Credit Union (STCU) has grown to be the third largest credit union in the state of Washington with $1.9 billion in assets and now serves over 125,000 members. We are very proud to be a part of the credit union community and believe this proposed rule, as currently written, would have widespread negative repercussions and be harmful to the credit union industry. Holding credit unions to a more stringent capital base than banks will force us to be less competitive in the marketplace and could result in a detrimental impact on the economic well-being of our members and the communities we serve.

STCU currently maintains a net capital ratio of 11%. Under the proposed rule, our risk based capital would be 14.75%. Like us, numerous credit unions will not need to make immediate changes to their balance sheets as they are already well-capitalized under the proposed Risk Based Capital rule. However, CUNA estimates that the credit union system as a whole would need to hold as much as $7.3 billion in additional capital to meet the well capitalized standard. Since credit unions cannot raise capital from the open market, but must build capital using earnings, we, as an industry, would be forced to increase loan rates, lower deposit rates, or increase fee income to raise the capital needed through earnings. Alternatively, credit unions would need to divest themselves of, or simply not offer, those products and services with unnecessarily high capital reserve requirements. Neither of these scenarios benefits our members or the solvency of the credit union industry.

While we agree changes should be made to the current capital rule, and welcome a system that adequately captures and measures the inherent risks in credit union assets, this proposal is not a suitable alternative. We would like to address our concerns and suggest modifications to the proposed rule.

Primary Concerns

The intent of this rule is to provide consistency in risk based capital requirements among federal regulators. Given the magnitude of losses the FDIC sustained in the past 6 years and the relatively low losses sustained by the NCUSIF, it would seem

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natural to conclude that the Basel III accord would require higher capital levels than the NCUA. However, just the opposite is true.

The primary differentiator is that Basel III does not attempt to measure interest rate and concentration risk in its risk based capital allocation. We would argue that those risks are better managed and monitored separately for the following reasons:

- Interest rate risk requires sophisticated modeling of the entire balance sheet, including liabilities. It cannot be adequately or effectively measured using only assets. By trying to include an interest rate risk component in the capital requirements, the board has introduced a number of incongruities such as:
    - Capital requirements are the same as or greater on a 5 year weighted average life security guaranteed by a US Gov't agency than on a delinquent unsecured consumer loan.
    - Treasury securities have just as much interest rate risk as US gov't agency securities yet they are given 0% risk weighting.
    - A 5 year weighted average life mortgage backed security guaranteed by a US Gov't agency has a greater risk weighting than an actual 30 year mortgage loan, which still contains credit risk.

- Requiring additional capital due to increased concentrations in assets is also ineffective as it does not incorporate the underwriting quality of the asset. Having concentrations in a given asset is not automatically equivalent to increased risk. There are many credit unions that exist to serve a specific industry, such as agriculture and business lending, that are well managed and who now face extinction as it will be extremely difficult for them to raise enough capital to meet the proposed requirements.

The idea of an all-inclusive risk measurement sounds good on paper, but is nearly impossible to reasonably put into practice. The result is a convoluted and seemingly arbitrary set of measurements that are not accurate or necessary. Our credit union has experts on staff and utilizes third party consultants to run and analyze numerous scenario and stress cases to determine our interest rate and concentration risk. We do so because it provides a clear picture of our risk profile. The proposal, as stated, brings no value to these complex and sophisticated calculations. Given that this proposal, as written, does not adequately evaluate interest rate risk or credit quality, we recommend the weightings should, at maximum, be consistent with Basel III standards.

The current proposal allowing examiners discretionary authority to impose additional capital requirements should be eliminated. This discretionary authority is a major flaw in the proposed rule. Creating a subjective goal line that can change will be impossible for credit union management and boards to manage to effectively. The application of this arbitrary discretion can only be inconsistent, and quite possibly, damaging. The proposal recommends a 1250% risk weighting when a credit union is unable to demonstrate a comprehensive understanding of asset-backed investments to examiners. This should be eliminated since it would also be based on subjective discretion.

Other risk weights that differ from Basel III or that should be reconsidered:

- Deposits at the Federal Reserve should have a risk weighting of 0%.

- There are multiple instances of unexplained overweighting. The areas particularly troubling include Corporate Credit Union Perpetual Capital (200%), investments in CUSO's (250%) and mortgage servicing assets (250%). The inexplicably high risk weightings incent credit unions to not participate in these activities. This hurts both the credit union and the member as there will be less income for the credit union and reduced services available for the member.

    - Perpetual Capital - The 200% risk weighting is perplexing, as the credit union is only at risk for the amount of capital invested. A 200% risk weighting would act as an incentive for credit unions to find a correspondent relationship elsewhere such as FHLB. And since corporates are being weaned off of paid in capital and growing capital solely through retained earnings, less members will certainly inhibit their growth, lessen their strength, and increase their risk. The maximum risk weighting for Perpetual Capital should be 100% or simply allow corporate credit unions to return the capital to credit unions, eliminating the category.

    - Investments in CUSO's (250%) - Evaluating the risk in CUSO's should not be a one size fits all mentality. CUSO's provide otherwise unavailable or less expensive services to the credit union industry and our members. CUSO's that are taking excessive risk should be evaluated and controlled through the regulatory exam process. It is short sighted to penalize all credit unions with investments in CUSO's regardless of risk. Without such analysis, the maximum risk weighting should be 100%.

    - Mortgage servicing assets (250%) - This appears to be a catch-22. Retaining mortgages is discouraged due to the proposed concentration tier percentages applicable to loans. Selling and retaining servicing is also discouraged through this weighting. The only outcome would seem to be either to not originate mortgages for our members at all, which puts credit unions at a distinct competitive disadvantage to our competitors, or sell the loans with servicing released, which potentially damages the relationship with the member. While a 250% risk weighting might be applicable when evaluating the quality of bank assets, credit unions, who historically have made safer credit decisions, should not be penalized due to the banking industry's mistakes. We ask the board to consider a 100% risk weighting for mortgage servicing rights.

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Other Concerns and Comments

- If the board is not flexible in removing a tiered approach for risk weighting of loans, we would encourage the board to consider tying risk weighting to loan performance. Loan loss experience, while not foolproof, is the most reasonable predictive indicator for future losses. It is not logical that a credit union with low losses should be held to the same standard as a credit union with excessive losses.

- Given that the lowest risk weighting for member business loans is 100%, we suggest elimination of the MBL cap. The credit risk in these loans has already been mitigated through the loan loss reserve and now the increased capital requirement.

- Limiting the ALLL to 1.25% of risk assets is questionable when the credit union has already provided for the allowance through earnings. Manipulation of ALLL to "manufacture" additional capital is controlled through the rules of GAAP and external auditors. Perhaps, the limitation should apply only for those credit unions that do not receive an unqualified opinion from an external CPA firm.

- The proposed rules require the NCUSIF deposit to be deducted from both risk assets and capital (i.e., both the numerator and denominator). Inherent in this treatment is the implication that the deposit is not an asset of a credit union and should be expensed. Since the NCUA continues to maintain that the deposit is a valid credit union asset, we believe the capital treatment should be consistent with that view (i.e., no risk asset or capital deduction).

- Lastly, the 18 month implementation timeline should be lengthened or phased in to provide credit unions more time to restructure their balance sheets if needed. This would allow time to accomplish balance sheet growth, loan sales, and other tactics in a thoughtful and strategic manner. Balance sheet restructuring simply to comply with regulatory changes rarely result in long-term success.

Thank you very much for the opportunity to comment on this proposed rule and for considering our views.

Sincerely,

Thomas Johnson

Thomas Johnson, CEO

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