COMMUNITY FIRST
Credit Union
Love Where You Bank

May 28, 2014

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

Re: Risk Based Capital Proposal

I am writing on behalf of Community First Credit Union, a community based credit union that serves consumers and businesses in Northeast Florida with assets of $1.3 billion and membership of 108,000. Community First appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) regarding its proposed rule that would shift our industry to a system of risk-based capital (RBC). As of the end of 2013, Community First far exceeded the requirements to be "well capitalized" under the proposed methodology. Even though the proposed changes do not immediately reduce our capital status, we are concerned about why RBC is needed now and question whether or not the proposed changes will achieve the NCUA's stated objective to "provide a common measure of asset risk and ensure that credit unions retain levels of capital that are commensurate with their level of risk." Our specific items of concern regarding features of the proposed regulation are covered in more detail below.

First, we question if there is a need for making this change at all. We believe that the current system of determining required capital performed remarkably well in protecting the share insurance fund during the most recent financial crisis. From 2008 through 2013, NCUSIF losses as a percentage of insured deposits were roughly a tenth of those experienced by the FDIC. Moreover, during this same period credit union loan losses were just 54% of bank loan losses or .90% compared with 1.62%. Only 26 credit unions with assets greater than $50 million failed, compared with nearly 500 community banks. Overall, our industry has demonstrated a solid track record of meeting the needs of members while prudently managing risks. The NCUA's comprehensive RBC proposal provides no evidence that if such a system were in place during the economic recession, it would have materially reduced the NCUSIF's losses. In contrast, when we read the Material Loss Reviews of larger credit unions performed by the NCUA's OIG, we note that many of these losses were caused by poorly executed and timed decisions to expand aggressively into lines of business that the credit union was ill equipped to handle. A common theme throughout these reports is that in almost all instances the NCUA could have mitigated losses through a more timely and aggressive supervisory approach.

Second, imposing the proposed system of RBC threatens the credit union industry by taking away excess capital available for expansion. According to a recent study by CUNA, in the aggregate the RBC system causes a $7.6 billion reduction in the amount of capital credit unions currently hold above the “well capitalized” threshold. The only way for credit unions to obtain more capital is by generating earnings, making capital an even scarcer resource. Reducing the capital buffer would stifle growth and reduce credit unions’ ability to serve their members, grow market share and ultimately survive in the long term. Moreover, beyond establishing thresholds for what is deemed “well capitalized” and “adequately capitalized” under the RBC system, the NCUA proposes that certain credit unions be required to hold even more capital on a case by case basis. We are concerned that the biases of individual examiners could result in this additional power being applied arbitrarily and inconsistently, resulting in the unfair treatment of some credit unions. Although under the proposed rule credit unions wishing to challenge this requirement would have a process for doing so, we question whether or not some credit unions would receive due process when making an appeal.

Third, we believe the proposal’s attempt to address credit risk, interest rate risk, liquidity risk and concentration risk through a system of assigning standardized asset risk weightings is inherently flawed. We do not believe it is realistic to create a “one size fits all” model that effectively addresses all of these risks using a system of risk based capital. Because of this overreaching attempt to resolve these risks using this one dimensional strategy, NCUA’s RBC proposal assigns seemingly arbitrary and at times conflicting weightings tied to the concentration of assets and average life of assets held on the balance sheet. As noted in many RBC comment letters submitted to the NCUA thus far, flaws in the individual asset weightings are a major concern of credit unions affected by this proposal. In contrast, Basel, the risk weighted capital system used by small banks, focuses mainly on the credit risk of the institution’s underlying assets. Under this system assets demonstrating higher historical losses receive higher risk weightings. Concentration risk and interest rate risk are dealt with through the supervisory and examination processes.

Given these concerns, we believe that NCUA should address balance sheet concentration risk and interest rate risk through existing regulation and examination methods rather than trying to control these risks through a system of RBC. As it currently stands, the NCUA’s final rule addressing interest rate risk (IRR) issued September 30, 2012, requires that credit unions adopt a written policy on interest rate risk management tied to the complexity of the credit union, along with a program to implement the policy effectively. In this rule the NCUA describes best practices for managing IRR from measuring risk effectively through modeling how the balance sheet of the credit union performs under different rate scenarios while incorporating assumptions about changes in member behavior and the speed in which assets reprice. We believe the requirements specified in this rule are rigorous and comprehensive. They require that credit unions address IRR holistically by looking at the entire balance sheet, assets and liabilities, and evaluate how changes in the market structure of interest rates affect the credit union's earnings and capital. Credit unions and examiners are provided clear guidelines for determining how effectively credit unions are managing safety and soundness. In contrast, when addressing interest rate risk the RBC approach proposed by the NCUA appears to be singularly focused on assigning risk to static pools of assets in isolation from the rest of the balance sheet, a flawed approach that runs counter to the principles of sound IRR management.

Similarly, we believe that the NCUA is more than adequately addressing concentration risk through Supervisory Letter 10-CU-03. This letter requires that credit unions establish a written policy that "addresses its philosophy on concentration risk, limits commensurate with net worth levels, and the rationale as to how the limits fit into the overall strategic plan of the credit union." The board of directors and senior management must establish systems and controls to ensure the credit union takes corrective actions when limits are approached or exceeded. Examiners are expected to review the credit union's policies and procedures for managing concentration risk to ensure they are being followed and they are adequate for the size and complexity of the credit union. In 10-CU-03 NCUA mentions specifically corrective actions examiners can take if they believe the credit union is not properly assessing or controlling the level of interest rate risk. These actions include requiring reduced limits on risk concentrations, reducing exposure to new business lines, transferring risks to other parties and ceasing a product or service line. Considering that the NCUA has these robust tools in place, it should address concentration risk through the supervision and examination processes rather than attempting to control this risk through its RBC proposal.

To summarize, we question why a risk based capital proposal is needed at this time, given how strongly credit unions performed during the most recent severe economic recession. While we see no evidence of how imposing this proposal would have reduced NCUSIF losses during the recession, looking forward we can clearly see how it could pose a threat to our industry by shutting down growth and causing credit unions to pull back on services to members, especially lending to small businesses and homeowners. Attempting to address credit risk, interest rate risk and concentration risk using the proposed RBC system is a flawed concept that results in unrealistic risk asset weightings that place an undue burden on credit unions. We believe the NCUA already has the power it needs to oversee all material risks effectively, if it is consistent, proactive, thorough and fair in its supervision and examination practices.

If the NCUA moves forward with the RBC proposal, we recommend that the following changes be incorporated:

- Change the asset weightings to be more in line with the weightings used under the Basel system for community banks and adjust these weightings to benefit credit unions when their assets have outperformed those of banks. For example, in determining the weightings for assets like member business loans, first mortgages and second mortgages, the NCUA should evaluate historical loss ratios compared to banks and calibrate the weightings accordingly. Weightings should not be based on the concentration of assets on the balance sheet or the average life of assets. As previously noted, regulating interest rate and concentration risks should be accomplished through the processes of examination and oversight.

- Eliminate the provision that authorizes the NCUA to require on a case by case basis that individual credit unions set aside capital in excess of the amounts required to be well capitalized under the RBC proposal. If the NCUA believes it needs to take aggressive measures to deal with a credit union posing a clear and imminent threat to the NCUSIF, it should do so by being thorough and proactive in its examination processes. As noted earlier, a common theme in many of the larger material loss reviews is examiners' failure to identify material issues early and take stronger supervisory action.

- Provide credit unions more time to comply with the risk based capital rule. We believe eighteen months leaves insufficient time for credit unions to assess the impact of the changes fully and adapt their strategic plans and business models to minimize the impact of the rule when meeting the needs of their members. We recommend three years as the lead time to be in compliance after the final regulation is published.

We appreciate having the opportunity to comment on this proposal. In determining where to move forward from here, we ask NCUA to consider our comments and those of other credit unions and carefully evaluate whether or not the RBC proposal would truly accomplish the objective of ensuring that credit unions "retain capital commensurate with their levels of risk" and whether or not this method would be an improvement over the system that we have today, one that has served our industry well through one of the most severe recessions in history.

If you have questions or need additional information, please feel free to contact me.

Sincerely,

John Hirabayashi

John Hirabayashi
President and CEO