May 27, 2014

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Service 1st Federal Credit Union
Charter: 22128

On behalf of Service 1st Federal Credit Union, we would like to provide the following comment letter for the record regarding the National Credit Union Administration (NCUA) proposed risk based capital rule approved by the NCUA board in January 2014.

Service 1st has long performed under the label of being "well-capitalized." Under the proposed regulation, our risk-based capital would drop to "adequately-capitalized." Service 1st has consistently outperformed other credit unions in our peer group on a yearly basis, leading up to being named Federal Credit Union of the Year by the National Association of Federal Credit Unions (NAFCU) in 2013.

Supplementing the existing one-size-fits-all net worth regime with a new one-size-fits-all set of risk-based capital standards does not make sense. Any capital or net worth system that does not accommodate the difference in asset risk-based upon the historical performance of our credit union in effectively managing that risk is flawed and doomed to restrain the very growth in reserves it is designed to foster through increased earnings. The paragraphs below outline our concerns of the NCUA's proposed risk based capital rule:

Loans to Credit Union Service Organizations (CUSO) and CUSO Investments

The NCUA has decided to apply a 100% risk-weight percentage to Loans to CUSO's and a 250% risk-weight percentage to Investments in CUSO's. This arbitrary risk-weight assignment is counterintuitive to the credit union philosophy of working together. We have successfully invested in several CUSO's and currently operate one wholly-owned. These successful investments will potentially penalize us in the future, even though the track record of these organizations is positive. Being able to collaborate with other credit union's via CUSO's allows credit unions to offer products and services to members that they would otherwise not be able to offer due to lack of resources and high startup costs. The NCUA has admitted a lack of data on CUSO's, so how does it justify the proposed risk-weight percentages?

Member Business Loan (MBL) Component

The NCUA has decided to apply risk-weight percentages to MBL's as they relate to asset size. We do not believe an MBL loan that puts our percentage over 25% of total assets is twice as risky as an MBL that represents the 1st percent. Again, I feel as though these risk-weighting percentages are arbitrary and there is insufficient data to make an informed rule. In the proposed rule, the NCUA states "... the failures of many small banks between 2008 and 2011 were also largely driven by high concentrations of MBLs." How can the NCUA justify this comparison? Credit unions, unlike banks, do not face the same pressures as banks do in regard to shareholder value and returns. Credit unions, unlike banks, are typically conservative with their MBL lending, and will loan to people in the community who they know. To say this risk-weight is accurate because it happened to banks is short-sighted. Our historical loss performance in this portfolio is less than half of what we've experienced in our indirect automobile, credit card, and unsecured portfolios. This rule does not take into account underwriting standards or collateral. An MBL that is fully secured should not be considered as risky as an unsecured MBL. I feel the NCUA needs to reconsider and rethink the proposed changes to MBLs.

Long-Term Real Estate Loans

The NCUA has decided to apply risk-weight percentages to real estate loans maturing, refinancing, or re-pricing in 5 years based on lien position and in relation to asset size. Again, the NCUA's general nature of rulemaking is short-sighted. How does a loan with a loan-to-value (LTV) of 10% carry the same risk as a loan with 100% LTV? Does a loan with a 6 year maturity, refinancing, or re-pricing pose that much more risk than a loan of 5 years? Is this rule focused more on interest rate risk than collateral risk? Rules like these will force us to change our Asset Liability Management strategies and replace them with the new proposed regulatory balance sheet requirements, adversely affecting our real estate loan products and all products across the board, thereby affecting our ability to meet member needs.

Non-Federally Guaranteed Student Loans

The NCUA has decided to apply a 100% risk-weight percentage to Non-Federally Guaranteed Student Loans. A 75% risk-weight percentage was applied to all other consumer loan types reported on the Call Report. While I understand the NCUA's concern about student loans in light of the current default rates on Federally Guaranteed Student Loans, credit unions can still take measures to protect themselves. Currently, we offer a student loan program which requires a co-signer, typically a parent, and offer a maximum of $50,000 over the course of the member's education. We also purchase insurance on that loan in event of a default. Granted, the insurance company could go out of business and be unavailable to pay a claim but all of the other consumer loan categories have similar concerns. A member could hide their vehicle and prevent us from repossessing it (and trust me, it happens often). One of the NCUA examiners who was just in our credit union said that it appears we have done all we can do to protect ourselves in this portfolio. The supervisory process would be a better way to assign risk-weighting percentages to these portfolios rather than an arbitrary number.

Individual Minimum Capital Requirements

The NCUA has included a rule to allow an individual minimum capital requirement (IMCR) be imposed on a credit union. The rule states "NCUA may establish increased individual minimum capital requirements upon its determination that the credit union's capital is or may be inadequate in view of the credit union's circumstances." My question is, after reading all of the examples listed thereafter in the proposed rule, how does a credit union manage to a risk-based capital requirement that may or may not be 10.5%? If the rule to be well-capitalized is 10.5% across the board, and all of the proposed rules are applied across the board, why was this added to be specifically about each credit union? It would make much more sense to apply risk-weightings that are specific to each individual credit union and keep a static target of 10.5% than to have a target that could potentially be adjusted higher.

Implementation Timeline

The effective date of the rule should be year-end 2018, at the earliest, not 18 months after finalizing the rule. To change the balance sheet in such a way to comply with the proposed rule cannot happen overnight. Credit union's need to be given ample time to shorten investment portfolios and make major changes in asset concentrations. They should not have to consider taking unnecessary losses in these portfolios in order to improve their risk-based capital position.

Our fear is that these rules, as proposed, will have the unintended consequences of restricting credit union growth, assisting members with products and services they want and need, and ultimately, resulting in less capital growth. Thank you for the opportunity to comment on this proposed regulation. While we do not believe the current proposal is significantly balanced and needs much refinement to be perfected, we encourage NCUA to consider some of the recommended improvements contained in this letter.

Respectfully,

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