Santa Ana Federal Credit Union

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Federal Credit Union

May 28, 2014

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

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

Dear Mr. Gerard Poliquin:

While we at Santa Ana Federal Credit Union are all for more sensible risk management among credit unions as a whole, the proposed Risk-Based Capital Rule appears to miss the mark in several areas. This credit union took a significant hit, as did all surviving Federal Credit Unions, for the mistakes made by and mismanagement of the Corporate FCUs, and other natural person credit unions, too. If you look back at our credit union's history, our prior management also made a reckless mistake with how we approached Indirect Lending headlong and without the proper safeguards in place. The difference in the two situations is that we were able to recover from our own direct mistakes, while we had to 'foot the bill' for the mistakes of others. Measuring the impact of the total bailout against our beginning Assets at the onset of the debacle, we lost more than 188 basis points between direct Corporate Capital charge-offs, Corporate Stabilization, and NCUSIF Assessments, 'to-date'. Any sensible risk management program that protects us from future systemic risk which, we are sure, is the intent of this proposal is welcome.

That leads us to the first point we do not understand about the calculation of the numerator. Why does the NCUSIF Deposit get eliminated from the numerator? A case can be made that its existence is additional protection against the very systemic risk for which this proposal is intended. (Note: All references to the ratio calculation from this point are based on our March 2014 Call Report and Risk-Based Capital estimate of 10.38 %.) If you do not eliminate the NCUSIF Deposit from the numerator and denominator, that alone would make us Well Capitalized at 11.54%. Our reason for recommending that you do not eliminate this 'buffer' against systemic losses from the calculation is that it is both extremely unlikely such an event risk could occur without almost-assured government intervention, and it would be replenished over time through assessments just as we most recently experienced. It can be argued that any such event would entirely wipe out the entire financial system and the only survivor would be a United States sponsored and supported public banking system.

Moving onto the Denominator, we question the Risk Weights in several areas. Firstly, in the area of Investments there is no allowance/credit given for maintaining investments within FDIC and NCUSIF insured guidelines. If there is no Principal Risk, then no such risk can be applied. The only remaining risks are Interest Rate Risk and Liquidity Risk, with the latter needing to be measured on a credit union by credit union basis based on the strength of its liquidity position. Our credit union is more than capable of holding its investments to maturity, and has always carried them as 'Hold to Maturity'. If a credit union can demonstrate through its strength of liquidity and contingency funding plans it is able to avoid selling its investments at a loss, it really does not matter how their market values are measured and no risk should be assigned.

The only time in the last ten years that the credit union elected to sell investments was to fund the CEO Split Dollar Plan, and to purchase BOLI. The risk treatment of these will be addressed later, but these were more like investment 'swap-outs' than anything else. Investment Interest Rate Risk remains and that does need to be measured commensurate with duration. However, for the most part and with very few exceptions, our longer term investments (more than five years) have been of the 'step' callable or floating variety. In a rising rate environment these will extend, but the rate steps significantly mitigate interest rate risk and should be treated differently than non-step investments. And, it is extremely difficult to make a case that the interest rate risk associated with step callable and floating investments could ever exceed 100% of the investment over the remaining life of the asset; any impact would be much less. Taking just a 100% maximum into the calculation of the denominator, and making no change to the numerator, our credit unions new Risk-Based Capital calculation would be a Well Capitalized 10.91% instead of 10.38%.

Secondly, we would like to point out that Concentration Risk is measured without regard to Terms or Loan to Value. Much more detail is required to break out Credit Risk and Interest Rate Risk than solely relying on Concentration. There should also be more realistic Risk Weights placed on Loans to reflect the potential for losses. Even during the most difficult period in financial history for Real Estate Losses our credit union suffered losses of only 34% of Net Worth while our Mortgage Loans as a percentage of Assets was 39% at the beginning of the economic difficulties. Actual Real Estate Losses represented only 9% of total Real Estate Loans. That experience has helped to make credit unions much more wary of potential losses and thusly has resulted in much better positioning of these assets on balance sheets making risk profiles much less severe. Risk Weights need to rely more heavily on Terms and LTVs.
Lastly, we wish to discuss the Risk Weights associated with the Split Dollar Plan and BOLI mentioned earlier. Even with the most recent failing of AIG, there has never been a life insurance policy holder loss in the history of the industry. Even AIGs Life Insurance policies were transferred to other providers thus protecting policyholders. The transfer of funds from highly liquid deposits into deposits in financial institutions into these two instruments resulted in a Risk Weight change of 100% on the $3.1 million that moved into Other Assets. This is an unrealistic Risk Weight measurement for the new instruments designed to offset Benefit Costs. In fact, the very nature of these instruments is that earnings increase significantly over time and continue increasing as

long as they are maintained. Reversing the effect of assigning a 100% Risk Weight to the insurance instruments results in an increase in the Risk-Based Capital Ratio from 10.38% to 11.19%.

Without adjusting for Loan Risk Weights, the combined impact of the three adjustments for the NCUSIF Deposit, Investments and Insurance instruments is 273 basis points. Any moderation of the Risk Weights will result in a Well Capitalized rating for our credit union. While it may be unlikely for the final rule to contain all of the changes discussed, the argument for moderating the Risk Weights assigned to these Assets is definitely warranted.

Sincerely,

Jill C. Mahany

Jill C. Mahany, CCE
President/CEO
Santa Ana Federal Credit Union

Cc: CCUL