May 28, 2014

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

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

Dear Mr. Poliquin:

Credit Union of New Jersey (CUNJ) appreciates the opportunity to comment on the National Credit Union Administration (NCUA) Board's proposal ("Proposal") to revise Prompt Corrective Action related to Risk-Based Capital. CUNJ serves 43,000 members and has assets of $330 million.

CUNJ understands the need to modernize credit union capital standards by the introduction of risk based concepts, and we are generally supportive of the federal and state regulatory efforts in this area. However, management believes the current Proposal will have negative effects not only for CUNJ and its members, but that it will produce negative unintended consequences that will affect many credit unions and their members.

We believe the Proposal, if adopted in its current form, would discourage investments in longer-term assets which are necessary for growth. This will negatively impact our market competiveness in pricing and ultimately decrease our ability to meet all of the needs of our members.

GENERAL COMMENTS

CUNJ believes that the same type of asset has the same risk regardless of whether it is held by a bank or a credit union. The Proposal arbitrarily assumes that many types of assets are riskier when held by credit unions rather than banks. By requiring credit unions to have much higher reserves to hold the same types of assets, the Proposed Rule would handicap the entire industry, thereby harming credit unions, their members, and the competitive landscape.

A recent analysis by CUNA of NCUSIF losses vs. FDIC losses from 2007 to 2013 shows the banking loss rate, with risk-based capital standards in place, was 8.8 times higher than credit union industry capital loss experience during the same period. During this period, the FDIC loss rate per $1,000 of deposits was $2.30 vs. the credit union loss rate of $0.26 per $1,000 of deposits. Yet, the Proposed Rule assumes that the exact same assets are riskier simply because they are held by a credit union rather than a bank, while these loss rate statistics prove the opposite. CUNJ believes that asset classifications should have the same risk weight whether the asset is held by a bank or credit union, and recommends that NCUA revise the proposed risk weightings to align the capital requirements significantly closer or equivalent to the BASEL III standards.

The differences between the Proposal and BASEL will make it more difficult for credit unions, as opposed to banks, to originate high quality loans to meet our members' needs and will reduce our credit union's growth. It will also result in losses in earnings and capital for credit unions, as members may need to go to banks for certain products and services due to the regulatory advantage banks would have over credit unions.

Using the existing BASEL III methodology results in increased risk based net worth compared to the Proposed Rule. By artificially lowering the capital ratio of credit unions, the Proposed Rule handicaps the ability of credit unions to service their members and compete with banks. The risk based capital disadvantage credit unions would suffer by using the Proposal calculation rather than BASEL III ultimately leads to lost opportunities in reasonable growth and competitive pricing. Adequate capital allows for growth, and arbitrarily reducing capital will substantially limit CUNJ's ability to grow and serve our members. The additional risk weighted capital reserves required under the NCUA Proposal over BASEL III will allow banks to effectively leverage their RB capital more efficiently than credit unions.

Unless modified, the Proposed Rule would over time reshape the credit union's business model as it relates to long term investment, lending, and expansion strategies. This will negatively impact the member experience and make the credit union less competitive with banks and other competing financial institutions. The Proposed Rule, in its current form, is likely to diminish market share growth, discourage the credit union from investing in branches, electronic delivery channels, new technologies, and in meeting the credit needs of our members, which will ultimately diminish our relevancy in the market.

We agree that the NCUA rules defining minimum capital requirements and Prompt Corrective Action may need revisions as a result of the 2007-2009 recession and Basel III. Please remember, however, that the credit union industry emerged from this recessionary period in recent history in considerably better shape than the banks – as detailed above, outperforming commercial and community banks in managing capital at risk exposure and losses, and did so without needing bail-out funds from the federal government. This alone is proof that the current RBC system in place worked effectively and, while it can be improved, is not in need of dramatic changes such as what has been proposed. If you take corporate credit unions out of the equation, the credit union industry did well during this severe economic recession. The table below shows the actual share insurance fund premiums compared to NCUA estimates:

Year	Estimated Stabilization Fund Assessment	Actual Stabilization Fund Assessment	Estimated Share Insurance Fund Premium	Actual Share Insurance Fund Premium
2009	N/A	4.73 bps	N/A	10.27 bps
2010	5-15 bps	13.4 bps	10-25 bps	12.42 bps
2011	20-25 bps	25.0 bps	0-10 bps	0 bps
2012	8-11 bps	9.5 bps	0-6 bps	0 bps
2013	8-11 bps	8.0 bps	0-5 bps	0 bps
2014	None	TBD	0-5 bps	TBD

While CUNJ does understand that some assets are inherently riskier than others, and a risk based capital ratio can be an effective method of analyzing financial institution risk, we feel that, even though credit unions outperformed banks during the recession, the Proposed Rule tends to substantially handicap credit unions as compared to banks by requiring more capital to hold the exact same types of assets.

There are vast differences in the Proposal's risk based capital reserve calculation between the Proposal and banks regulated by the OCC, FRB, and FDIC under BASEL. The Proposal's real estate loan risk weighting requirement of 50% to 150% compared to BASEL's 50% risk weighting would suggest that that either these banking regulators, including the Federal Reserve, have totally missed the concept of exposure to concentration, interest rate and liquidity risks, or these assets are too heavily over-weighted in the Proposal. The fact is that BASEL and bank regulators recognize that the effective complement to capital standards in assessing safety and soundness are regulatory examinations.

While Capital is considered the safety net to absorb losses, it does not serve in itself as the best long-term predicator of a financial institution's failure nor can it take the place of a solid Regulatory Safety and Soundness examination process which assesses the associated interest rate, liquidity, operational and other risks. The banking regulators approach is indicated by their examination approach which further expands CAMEL by adding an "S" component for market sensitivity with the understanding that a Well Capitalized capital level alone, in itself, is not the ultimate predictive power of on institution's failure. In one study, it was noted that among the 322 banks that failed from 2008 to 2010 nearly all remained Well Capitalized, on average, only 403 days in advance of failure which illustrates that simply higher risk based capital levels in themselves do not address the problem. In fact, an argument could be made that banks have had risk-based capital requirements for decades and yet these requirements in themselves neither prevented the latest crisis in 2007 nor stopped significant failures in the banking system.

Given the historical differences in credit union vs. commercial and/or community bank capital at risk exposure, we believe that any such modernization should take into consideration the unique characteristics and qualities of credit unions, the need to identify credit unions with excessive risk, and the need to create a risk-based standard that is comparable to Prompt Corrective Action systems that are employed by other Federal Banking Regulatory Agencies under BASEL III. As such, the current proposal does not appear to be comparable enough in what appears to be excessive capital reserve measures for interest rate and concentration risk nor in being comparable to the BASEL accord implementation period.

If there is data available to suggest a conclusion different from ours, then we are asking the NCUA to present it to support the proposed risk weightings. Outlined below are the areas that CUNJ is asking the NCUA to reconsider for the development of the final version of the Risk-Based Capital Rule:

RISK WEIGHTING COMMENTS

The Proposal assigns higher asset risk weightings than BASEL III in all but one asset category. In some cases, NCUA places significantly higher asset risk weightings than BASEL III, which would require credit unions to hold more capital than banks for the same assets. This would place credit unions at a competitive pricing disadvantage in an already highly competitive marketplace.

In addition, insisting on using higher than BASEL tiered risk weightings on real estate loan assets in an effort to address concentration and interest rate risk is not reflective of the true interest rate risk and valuation loss exposure by not considering variable rate real estate loans or loan-to-values.

Cash Held at the Federal Reserve

CUNJ maintains a substantial deposit balance at the Federal Reserve as an alternative to short term investments and as a source of liquidity. Under the Proposed Rule, cash balances being held at the Federal Reserve are given a 20% risk weighting. Given that the Federal Reserve has been designated as a source for emergency liquidity for the entire credit union industry, there appears to be little risk in holding cash balance at the Federal Reserve. Under Basel III, central bank reserves are deemed to be highly liquid assets during a time of stress and carry a 0% risk weighting. NCUA should consider giving cash balances being held at the Federal Reserve a 0% risk weighting in the final version of the Rule.

Investments

Under the Proposed Rule, investment risk weightings for credit unions are significantly higher than that of banks. BASEL III assigns asset risk weightings based on collateral types and the guarantees associated with the securities. NCUA's Proposal assigns asset risk weightings on investments based on Weighted Average Life of the securities. The NCUA risk weights appear punitive and somewhat inconsistent when comparing interest rate and credit risks in loan assets and the BASEL standards. The over weighting puts credit unions at a disadvantage which will ultimately lead to a critical reduction in earnings added to capital in real dollars.

The Proposal lists all US Government direct obligations including US Treasury securities, those securities guaranteed by the NCUA or FDIC carry a 0% risk weight, disregarding the maturity. Other Agency backed securities with no credit risk, such as Fannie Mae and Freddie Mac, are risk weighted based on weighted average life time buckets, which is inconsistent in measuring interest rate and liquidity risk. By adding additional tiered concentration levels for US Government Agency backed investments based on weighted average life in an effort to manage interest rate risk creates a fundamental risk management problem. For example, the Proposal's Asset Risk Weighing of a 30 Year US Treasury carries a 0% asset risk weighting, while an agency back security with 5 years weighted average life carries a 150% asset risk weighting.

Investments with weighted average lives greater than 5 years are given extremely high risk weights of 150% for 5 to 10 year average lives and 200% for average lives greater than 10 years. This compares to 20% risk weightings for similar securities in the banking model. In addition, a 30 year real estate loan mortgage on our balance sheet would carry a 50% risk weighting while securitizing the same loan into a 30 year FNMA security, with enhanced liquidity, would carry a 150% risk weighting.

CUNJ believes the final version of the Rule should more closely mirror BASEL III risk weightings for investments to correct the Proposal's inconsistency. By adding the additional risk weightings above the BASEL standards, the proposed asset risk weightings fail to consider whether interest rate risk is balanced with credit union's Asset Liability Management as a whole and on-going management of the balance sheet.

In order to be consistent, the Proposal should also include Small Business Administration (SBA) pools, Agency backed investments, and other US Government direct obligations at 0% risk weighting – as under BASEL. We believe there should be no risk weightings on investments greater than 100%.

Real Estate Loans

First Mortgage Loans: On the commentary related to first mortgages, there is a lot of discussion about concentration risk and the commentary indicates losses during the recession. When you look back over 40 – 50 years, real estate loans have been very safe. Real estate values bottomed out approximately two to three years ago and are increasing nationwide. All signs point to a continued recovery in the housing market. The Proposal is written as if we are going to continue to be facing the real estate market conditions that we dealt with during the recent recession. The proposed risk weightings would make it difficult for us to compete in what is already a highly competitive marketplace.

The Proposal assigns higher asset risk weightings as their concentrations as percentages of total assets increase. BASEL III assigns a 50% asset risk weighting on 1st mortgage loans regardless of their concentrations. We believe the Proposal should mirror BASEL III in this area.

Under the Proposed Rule, no distinction is made on the risk weightings assigned to mortgage loans of various maturity and repricing terms. A 30 year fixed rate mortgage is assigned the same risk weight as a one year adjustable rate mortgage and a 15 year fixed rate home equity loan gets the same risk weight as a variable rate home equity line of credit. As opposed to implementing risk-based capital standards that unfairly combine all mortgage loans together, there should there be more diversity in the risk weighting under the proposal.

CUNJ’s balance sheet is well positioned for a rising rate environment, by design. We have monitored and managed our first mortgage portfolio since the inception of the program in the late 1990’s to ensure that the portfolio is diversified in structure, has re-pricing characteristics and produces strong, stable principal cash flows that limit exposure to rising interest rates. Currently, one-third of our first mortgage portfolio consists of adjustable rate loans, and only 22% of the total portfolio consists of 30 year fixed rate loans. Portfolio is 22.81% of our total assets. Under the Proposed Rule, there would be no difference between CUNJ's capital requirement for its diverse mortgage portfolio and the capital requirements for a credit union that holds the same size portfolio consisting entirely of 30 year mortgages. Also under the proposal, A portfolio of 100% ARMs, averaging 50% LTV, that was 35% of a credit union’s total assets would be considered a higher risk than a portfolio of another credit union that was 25% of total assets, averaged 80% LTV and was comprised 100% of 30 year fixed rate mortgages.

CUNJ believes that the capital requirement for adjustable rate mortgages and shorter maturity fixed-rate mortgage loans should be lowered in the final version of the Rule to fairly take into consideration the reduced risk associated with these adjustable and shorter term mortgage loan products. The Proposal should at least adjust to BASEL concentration standards with the conclusion that regulatory examination of concentrations is more appropriate.

Second Mortgages: Commentary in the second mortgage area talks about high losses in the products, which is related only to the recession. Looking back over the last thirty or forty years, their loss ratios have mirrored their mortgage products with the exception of the recession. Once again, the regulation is written under the assumption that we are going to continue to be facing the issues of the recent recession. The Proposal assigns asset risk weightings of 100% to 150% depending on the concentration of those loans as percentages of total assets. BASEL III assigns only a 50% asset risk weights on those loans regardless of concentration. The proposed asset risk weightings seem excessively punitive for credit unions that provide home equity loans to members. In its current form, the Proposal suggests that unsecured consumer loans are lower risk than real estate secured home equity loans.

Member Business Loans

The NCUA Proposed Rule creates a bias in favor of consumer loans as opposed to other assets such as member business loans. Consumer loans are assigned a 75% risk weighting while member business loans are subject to concentration-based tiered asset risk weightings from 100% to 200%. The Proposal appears to favor lower quality indirect and unsecured loans over higher quality and more secured member business loans. A higher risk of unintended consequences may exist as some credits unions attempt to increase production in lesser quality indirect consumer auto and unsecured consumer loans rather than higher quality, more secure member business loans in an effort to improve risk based capital levels - with a misplaced view of having less risk exposure.

Under BASEL there is essentially a more effective 100% risk weighting by the approach to assigning commercial loan risk weightings based on collateral, loan-to-values, and other specific loan characteristics before requiring higher risk weighted capital reserves – more tailored to the underlining credit risk exposure.

According to studies we have reviewed, it appears that the risk weightings found in the Proposal are not based on credit unions experiencing higher losses than banks. We would like to get an understanding and see the analysis included in the NCUA's perspective on assigning such higher asset risk weightings comparing to BASEL III.

Credit Union Service Organizations (CUSOs)

The Proposal assigns an extremely high risk weighting of 250% on total investment in CUSOs. There are no differentiations made based on the business purpose of the CUSOs, the ownership structure (single or multiple owners) of the CUSOs, or the corporate structure of the CUSOs.

We understand the asset risk weightings on CUSO investment in the Proposal was the result of NCUA comparing bank investment risk weighting under BASEL III. However, BASEL III investment for banks certainly will be different from the cooperative nature of why CUSOs are formed in the credit union. Therefore, comparisons of CUSOs to commercial bank risk based investment limits in equity positions of publicly held corporations appear in our view as inconsistent as to purposes.

We believe investments in CUSOs should be risk weighted at 100% under the Proposed Rule. Well managed involvement with these CUSOs has often increased a credit union's profitability by contributing to increased loan production and by helping to reduce operating expenses.

As NCUA already limits a credit union's investment in CUSOs, under NCUA Rule 712.4, there appears to be little rationale for imposing a 250% risk weighting on CUSO investments. We know of no statistical evidence of CUSOs causing material losses to support the excessive capital proposed to be reserved. Additionally, the risk weighting of 250% for a performing CUSO exceeding the risk weighting of a delinquent consumer loan at 150% does not appear logical.

CUNJ is currently involved in a CUSO relationship with two other credit unions for the purpose of consolidating functions in an effort to reduce operating expenses to offset declining net interest income and noninterest income levels. We feel that the inflated risk weighting on CUSO investments may hinder similar efforts among credit unions at a time when such collaborations are vital to the future success of the industry.

<u>Allowance Risk Based Limit</u>

We believe consideration should be given to increasing the 1.25% allowance limit for adding to the numerator should FASB adopt the Current Expected Credit Loss model. In the event of passage of FASB's proposed new standard on the allowance it is most likely to increase normal reserves by an estimated 30% to 100% at some credit unions.

CUNJ believes there should be no cap on the allowance counting towards capital, particularly in view of the possibility of higher credit allowance standards being adopted in the future.

<u>Delinquent loans:</u> We believe the Proposal should be consistent with BASEL IIIs definition of delinquent loans for risk based capital calculation purposes. Under BASEL III, assets are classified as delinquent once they become 90 days past due, which is typically the point at which GAAP requires non-accrual of interest and reversal of any previously accrued interest. This risk based treatment would not diminish the ALLL methodology for calculating adequate loss reserves and would be consistent with other financial institutions.

<u>National Credit Union Share Insurance Fund (NCUSIF) Deposit</u>

The Proposal excludes the NCUSIF Deposit from both the numerator (capital) and the denominator (risk weighted assets) of the Risk Based Capital calculation. Despite the published comments by the NCUA stating that the treatment should not affect GAAP accounting of the deposit, the implication is that this is not a true asset of the credit union and we should write down the NCUSIF Deposit immediately when it comes to the Risk Based Capital calculation. We believe this is not a proper treatment of the NCUSIF Deposit as there are no indications that the 1% NCUSIF Deposit will be expensed in the foreseeable future.

The NCUSIF deposit is a valid asset that can be refunded for various reasons including conversion to a bank or savings institution charter, a credit union electing private insurance instead of NCUA or voluntary liquidation. In addition, the deposit can specifically be attributable to a failed credit union providing an additional buffer against NCUSIF losses in addition to the failed credit union's capital. It is for these reasons we believe NCUA should modify the Proposal to include the NCUSIF Deposit in both the numerator and the denominator of the Risk Based Capital calculation.

<u>Individual Minimum Capital Requirements (IMCR)</u>

Section 702.105(b) of the Proposal allows NCUA to establish higher minimum capital requirements for individual credit unions. This section provides a list of items that can trigger IMCR. However, there are some gray areas (i.e. high degree of exposure to prepayment risk, concentration risk, and poor liquidity or cash flow) that can have a wide range of interpretations between NCUA examiners and credit union management. This proposed rule allows the NCUA to substitute the judgment and expertise of the examiners for that of the credit union managements and boards.

We can understand the necessity for regulatory flexibility; however, our main concern is that the proposed rule appears in present form as a subjective measurement. By definition, a subjective measurement will vary from credit union to credit union, examiner to examiner, and region to region. This lack of consistency could open the door for unintended examiner bias and create uncertainty on how the credit union managements and boards can go about managing the day to day operations without triggering the IMCR.

We believe the NCUA needs to either delete this section or provide a clear-cut mechanism outlining how IMCR will be determined and what can credit unions do to be excluded from the IMCR group.

Implementation

The Proposal has an 18-month implementation time frame for credit unions to comply with the new Risk Based Capital requirement. This does not allow for adequate transition and is well short of the BASEL III five-year implementation period for banks with the additional 2.5% capital conversion buffer not fully phased in until 12/31/2018. Once the Proposal is finalized and implemented, credit unions will need time to adjust some of the asset categories to create well rounds balance sheet that align earnings and risks. We believe an 18-month implementation period doesn't give credit union managements and board members ample time to make sounds decisions.

As a result, we believe that NCUA should allow credit unions the same amount of time to fully implement the Risk Based Capital as our counterparts in the banking industry.

SUMMARY

Applying a Risk Based Capital methodology has value by taking into consideration the different asset classes containing different loss experience as seen by the fact that the additional calculation is recognized by the U.S. banking and international banking communities. Although we support the general intent of the Proposal, we believe there are major modifications needed to the Proposal to allow the credit union industry to stay competitive with the banking industry.

Given the lower capital at risk profile of the credit union industry compared to the banking sector, requiring higher capital reserves for credit unions is inconsistent with empirical data of performance and loss history between natural person credit unions and banks. A higher risk based capital standard for credit unions is not consistent with the risk exposure at the present or during the most difficult period of the recent recession, from 2008 through 2010.

The additional risk weighted capital reserves required under the NCUA Proposal over BASEL III equates to lost opportunity in our credit union's earnings in comparison to a similar sized community bank and may result in an inability to serve our members' needs.

A more stringent Rule than BASEL III Risk Based Capital requirement will put a number of credit unions in a significant competitive disadvantage compared to banks. The higher product costs and lower returns will jeopardize the relationships credit unions built with their loyal members, and may at times force them to send their loyal members to banks to obtain certain products they desire due to regulatory differences.   Considering the performance of credit union compared to banks during the recent recession, a more stringent rule than our current rule is also not necessary.

Raising Risk Weighted Capital levels does not serve as the ultimate long-term indicator of bank and credit union failures and is not an effective substitute for effective regulatory safety & soundness examinations which includes a proper assessment of interest rate, operational, and liquidity risks. There is no data available to us to suggest that efforts to somehow aggregate all of these risks into a high level macro reserve number higher than the standards of BASEL III is the right approach. It appears to us that a better approach to address the NCUA's interest rate risk and concentration concerns is continued effective regulatory safety & soundness examinations with possibly an added "S" (sensitivity to market risk) component in the exam process.

We urge the NCUA to reconsider the content and parameters of the Proposal. We also urge the NCUA to adjust the proposal to provide an environment which the experience and expertise of credit union management and boards can be maximized to create a more prosperous credit union industry.

CUNJ believes that with modifications to the Proposed Rule based on objective criteria, the final version of the Risk-Based Capital Rule could in fact be a significant improvement over current Risk Based Net Worth. The important issue is to get the capital standards correctly modernized and in line with accepted standards recognized by United States and regulatory agencies in the rest of the world.

Thank you for the opportunity to comment on the Proposed Rule. Please feel free to contact us with any questions or comments.

Sincerely,

Robert M Vuocolo

Robert M. Vuocolo
CFO