Public Service
Credit Union
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May 23, 2014

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

RE: Comments on Proposal: PCA - Risk-Based Capital

Dear Mr. Poliquin:

Public Service Credit Union ("PSCU") would like to take the opportunity to comment on the National Credit Union Administration ("NCUA") Board's proposal ("Proposal") to revise its Prompt Corrective Action rules related to Risk-Based Capital.

PSCU, located in Denver, Colorado, serves one hundred fifty thousand (150,000) members, has one billion four hundred million dollars ($1.4 billion) in assets, and 10.4% in net worth.

PSCU agrees with 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, we believe the Proposal, if adopted in the current form, is not only a violation of the Federal Credit Union Act ("Act"), but the means by which the credit union business model may ultimately become irrelevant.

GENERAL COMMENTS

Many of those who have reviewed the Proposal have determined that it violates both the language of the Act and its underlying intent, which is to support the credit union business model. The Act accomplishes this by taking into consideration the industry's not-for-profit status and its limited opportunity to raise capital. The Act lays the foundation for sound credit unions that aim to operate financial cooperatives in a for-profit industry, while being duly mindful of risks to the National Credit Union Share Insurance Fund ("NCUSIF"). To adopt the Proposal as drafted would run counter to the intent of the Act.

The Proposal arbitrarily burdens the credit union industry by assuming that many types of assets are riskier when held by credit unions rather than banks. Credit unions should not be held to a higher standard than their bank counterparts. PSCU believes that asset classifications should have the same risk weight whether the asset is held by a bank or credit union. PSCU is asking the NCUA to revise the proposed risk weightings to align the capital requirements closer to those articulated in the BASEL III standards.

The effect of the Proposal is evident when comparing PSCU's risk based net worth ratio under the Proposal and BASEL III:

PSCU's RB Capital under the Proposal's standards:	13.69%
PSCU's RB Capital under the BASEL III standards:	15.70%

Using the existing BASEL III methodology results in over fifteen percent (15%) more risk based net worth than the Proposal. The additional risk weighted capital reserves required under the NCUA Proposal versus BASEL III average an estimated two hundred (200) basis points for PSCU.

The Proposal, in its current form, is likely to diminish market share growth, discourage the credit union from investing in branches, delivery channels, new technologies, and in meeting the credit needs of our members, which will ultimately diminish our relevancy in the market.

PSCU agrees with the need for the modernization of NCUA rules, defining minimum capital requirements and Prompt Corrective Action given the recent “Great Recession” and the standards of Basel III. In addition, we agree with the premise that some assets are inherently riskier than others are, and that therefore a risk based capital ratio is a good method of analyzing financial institution risk.

We categorically disagree that the Proposal should substantially handicap credit unions compared to banks by requiring more capital to hold the exact same types of assets.

RISK WEIGHTING COMMENTS

The Proposal assigns higher asset risk weightings than BASEL III in all but one (1) asset category. In some cases, the Proposal places significantly higher asset risk weightings than BASEL III. Under the Proposal, credit union risk weights would be higher than those applying to banks, which would require credit unions to hold more capital than banks for equivalent assets. This is a major concern to PSCU, as it would place credit unions at a competitive pricing disadvantage in an already highly competitive marketplace.

Cash Held at the Federal Reserve
Under the Proposal, cash balances held at the Federal Reserve hold a twenty percent (20%) risk weighting, while under Basel III central bank reserves are deemed to be liquid assets and carry a zero percent (0%) risk weighting. PSCU maintains a substantial deposit balance at the Federal Reserve as a source of liquidity. Federal Reserve deposits are monitored on a daily basis by the institution and weekly by the Federal Reserve itself, therefore any possible inherent risks in these deposits are thoroughly mitigated.

PSCU believes cash balances being held at the Federal Reserve should be given a 0% risk weighting in the final version of the Rule.

Investments
Under the Proposal, investment risk weightings for credit unions are significantly higher than those applying to banks. BASEL III assigns asset risk weightings based on collateral types and the guarantees associated with the securities. The Proposal assigns asset risk weightings for investments based on the Weighted Average Life of the securities. PSCU believes that collateral and the guarantee associated with securities is a more accurate assessment of the risk the investment, in accordance with BASEL III.

PSCU also has concerns with the Proposal's inconsistent, treatment of investments. The Proposal provides that all US Government direct obligations, including US Treasury securities and securities guaranteed by the NCUA or FDIC, carry a 0% risk weight, regardless of the security's maturity. On the other hand, securities backed by other agencies, such as Fannie Mae and Freddie Mac, are risk weighted based on their weighted average lifetime buckets, resulting in an inconsistent method for measuring interest rate and liquidity risk. Additionally, the Proposal does not include Small Business Administration (“SBA”) pools, Ginnie Mae backed investments, and other US Government direct obligations, which should also be risk weighted at 0% consistent with BASEL III.

To demonstrate the inconsistency in measuring investments within this model, you may evaluate the punitive risk weightings within the Proposal and apply them to one of the financial industry's staple offerings, the thirty (30) year real estate mortgage, compared to a similarly termed security. The proposal offers the following "average lifetime buckets" and their respective punitive risk weighting: weighted average lives greater than five (5) years have a punitive risk weight of one hundred fifty percent (150%) while average lives greater than ten (10) years are punitively risk weighted at two hundred percent (200%). This compares to a twenty percent (20%) risk weightings for similar securities in the banking model. Demonstrably, a 30-year real estate loan mortgage on PSCU's balance sheet would carry a fifty percent (50%) risk weighting while securitizing the same loan into a 30-year FNMA security, with enhanced liquidity and negligible credit risk, would carry a 150% risk weighting.

PSCU believes investments should be risk weighted on the same basis as the BASEL III standards, to prevent credit unions from being forced into an unfair and unjustifiable market disadvantage.

<u>Real Estate Loans</u>
The Proposal assigns higher asset risk weightings as a credit union's concentrations of first mortgage loans as a percentage of total assets increase, without consideration for term; no distinction is made on the risk weightings assigned to mortgage loans of various maturity and re-pricing terms. A 30-year fixed rate mortgage has the same risk weight as a one-year adjustable rate mortgage and the same risk weight as a variable rate home equity line of credit. BASEL III assigns a 50% asset risk weighting on both first and second mortgage loans regardless of their concentrations.

PSCU finds the Proposal's treatment of PSCU's capital requirement for its diverse mortgage portfolio, and the capital requirements for a credit union that holds all 30-year mortgages in the balance sheet, an inadequate means to mitigate risk within a mortgage loan portfolio.

PSCU believes that the Proposal's concentration standards are not appropriate, and should be evaluated in the context of the regulatory examination where the credit union's real estate portfolio may be reviewed in its entirety.

<u>Member Business Loans</u>
The Proposal creates a bias in favor of consumer loans compared to other assets such as member business loans ("MBLs"). Consumer loans would carry a seventy-five percent (75%) risk weighting while MBLs would be subject to concentration-based tiered asset risk weightings from one hundred percent (100%) to 200%. As this risk weighting attempts to address concentration risk, we recommend the recognition of the effective mitigation of MBL concentration with the current regulatory cap of twelve and one quarter percent (12.25%) of asset restriction on the MBL portfolio.

BASEL III provides for a more effective 100% risk weighting in assigning commercial loan risk weightings based on collateral, loan-to-values, and other specific loan characteristics before requiring higher risk weighted capital reserves; this results in a more tailored assessment of the underlining credit risk exposure.

PSCU urges the NCUA to reconsider and remove portions of the Proposal that apply higher risk weights to MBLs based on a percentage of the credit union's assets in that category.

<u>Credit Union Service Organizations ("CUSOs")</u>

The Proposal assigns a two hundred fifty percent (250%) asset risk weighting on total investment in CUSOs. No differentiations are made based on the business purpose, the ownership structure (single or multiple owners), or the corporate structure of the CUSOs.

We believe investments in CUSOs should be risk weighted at 100% compared to 250% under the Proposal. Well-managed involvement with CUSOs has often benefited a credit union's profitability by contributing to increased loan production and by helping to reduce operating expenses.

The NCUA already limits a credit union's investment in CUSOs, under NCUA Rule 712.4, so there appears to be little justification for imposing a 250% risk weighting on CUSO investments.

PSCU believes CUSO investments are adequately mitigated and reviewed and should therefore be risk weighted at no more than 100%.

Allowance Risk Based Limit

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 will likely increase normal reserves by an estimated 30% to 100% at some credit unions.

PSCU 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.

National Credit Union Share Insurance Fund ("NCUSIF") Deposit

The Proposal excludes the NCUSIF Deposit from both the numerator (capital) and the denominator (risk-weighted assets) of the Risk Based Capital calculation. This is not a proper treatment of the NCUSIF Deposit, as there are no indications that the one percent (1%) NCUSIF Deposit will be expensed in the near future. In addition, goodwill is also not anticipated to be expensed in the near future and should remain as part of the numerator in support of GAAP accounting treatment.

The NCUA should modify the Proposal to include the NCUSIF Deposit in both the numerator and the denominator of the Risk Based Capital calculation and allow goodwill to remain in the calculation.

Individual Minimum Capital Requirements ("IMCR")

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, some gray areas (i.e., high degree of exposure to prepayment risk, concentration risk, and poor liquidity or cash flow) can have a wide range of interpretations between NCUA examiners and credit union management.

We understand the necessity for regulatory flexibility; however, our main concern is that the Proposal 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 credit union management and boards can manage day to day operations without triggering the IMCR.

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

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 U.S. banking and international banking communities recognize the additional calculation. PSCU believes the Proposal needs major modifications to allow the credit union industry to remain a competitive and relevant in the financial services market, as intended by the Act.

We urge the NCUA to reconsider the content and parameters of the Proposal. PSCU is confident that with modifications to the Proposal based on objective criteria, the final version of the Risk-Based Capital Rule could in fact be a significant improvement over the current Risk Based Net Worth approach. It is important that capital standards applicable to credit unions be appropriately modernized and brought into alignment with the standards recognized and accepted by the United States and regulatory agencies in the rest of the world.

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

Sincerely,

[SIGNED]
Colleen Knoll
Senior Vice President and
Chief Financial Officer