First Tech federal credit union

May 28, 2014

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

Re: **Commentary on NCUA Proposed Prompt Corrective Action—Risk-Based Capital Rules - RIN 3133–AD77**

Dear Secretary Poliquin,

First Technology Federal Credit Union ("First Tech" or "Credit Union") respectfully submits this commentary in response to the National Credit Union Administration's ("NCUA") proposed regulations entitled "Prompt Corrective Action – Risk Based Capital." While we applaud the NCUA's efforts to address long standing weaknesses in the NCUA's capital regulations, we believe the proposed Risk-Based Capital regulations are seriously flawed and will, in our informed opinion, cause serious harm to the industry that the NCUA is charged to protect. In this comment letter we hope to express our views on a number of the elements contained in the proposed rulemaking, while also offering suggestions on how the NCUA might better promote safe and sound growth while mitigating risk to the insurance fund.

Conclusion:
We believe that the interest of the Credit Union industry and the NCUA would be best served by: (1) materially altering the current proposal to cause it to meet statutory minimums under Prompt Corrective Action rules, while otherwise following Basel III guidelines adopted by all other U.S. Banking regulators; (2) improving the qualitative element of effective supervision by: (a) increasing the quantity of NCUA field examiners and time allocated to examinations; (b) providing additional examiner training to enable our great examiners to take a "risk based" approach to supervision, which is a better indicator of capacity to manage and absorb risk that the arbitrary capital levels provided in the proposed regulation; (3) follow the advice of your Inspector General and others to invest in supervision and risk management tools to better enable the NCUA to get ahead of risk; and (4) utilize existing statutory authority to impose Individual Minimum Capital Requirement ("IMCR"), or other enforcement actions, on those credit unions that fail to maintain effective risk management practices. In our opinion, this four point strategy creates consistency and fairness between charters, rewards credit unions for strong risk management efforts, empowers smart examiners and supervisory staff, and creates strong disincentives for excessive risk taking. While some in the industry may chafe at higher levels of

supervision and more comprehensive examinations, the true cost of this burden will be much lower than the economic costs associated with implementation of the proposed regulation and/or CU failures. In our opinion, the NCUA's currently proposed "shotgun" policy of imposing higher capital requirements on all Credit unions, regardless of the quality and effectiveness of their risk management activities fails to leverage existing best practices poor practices of the "least common denominator" among credit union operators while adversely impacting earnings, member service, and other risk management activities of well run Credit unions.

First Tech is a $6.7 billion total asset federal credit union serving nearly 380,000 members, more than 100,000 of which are actively employed by the Nation's leading technology companies. We view ourselves as a progressive, financially sound, "well-capitalized" and well managed credit union. Internally prepared analysis and the NCUA's calculation for the proposed Risk-Based Capital rule indicate that First Tech would continue to be considered "well-capitalized." That said, the proposed Risk-Based Capital regulations would, in our opinion, unduly interfere with the Credit Union's sound management of risk and hamper its ability to remain competitive with banks and other non-credit union financial services providers. Further, the "unlevel playing field" and arbitrary risk-weightings created by the proposed rule will restrict our growth, result in higher levels of credit risk, reduce long term earnings, and severely limit our ability to accumulate capital needed to serve the more than 800,000 individuals employed by our SEG base.

First Tech provides the following comments to the NCUA in hopes that the agency will reconsider the proposed regulations in favor of adopting a regulation that mirrors the Basel III Capital Rules adopted for banks while following proven interest rate, credit and concentration risk management protocols applied by other federal banking regulators. While we applaud your efforts to improve upon historic capital rules, we believe that the "one size fits all" approach to regulation through capital planning is seriously flawed and must be modified if you are to avoid a host of unintended consequences.

NCUA Goals for the Proposed Rule:
The summary section of the proposal states that the NCUA set forth specific goals when developing the risk-based capital requirements under the proposed rule. Those goals are set forth as follows:

> First, the capital requirement should address weaknesses in the net worth ratio measure. Second, the requirement should address credit risk, interest rate risk, concentration risk, liquidity risk, operational risk, and market risk. Third, the requirement should enhance the stability of the credit union system. Fourth, the rule should rely primarily on data already collected on the Call Report to minimize additional recordkeeping burdens. Fifth, the requirement should be, given the preceding four goals, as easy as possible to understand and implement.

The NCUA's attempt to control all risks facing credit unions through a single capital ratio is misplaced.

The NCUA's proposed Risk-Based Capital rules inappropriately eclipse the Basel III capital rules imposed on banks by seeking to control all areas of risk (credit, interest rate, concentration, liquidity, operational, and market) through a single "one size fits all" capital ratio measurement. The proposal does not properly consider the adverse impact this single measure may have on a credit union's ability to properly manage its risk exposure and does nothing to recognize the expertise of credit union management or the quality of their risk management programs. Strong risk focused policy must focus on both the quantity of risk and quality of risk management activities.

In our opinion, the proposed rule creates a number of "unintended consequences" for the NCUA. In this regard, the proposed risk-weight categories incentivize credit unions to reduce interest rate risk while substantially increasing credit risk. This makes no sense! The proposal also effectively forces those credit unions with concentrations in high quality single family loans (e.g. First Tech's portfolio with modest advance rates and an average FICO of 753) to either increase rates to non-competitive levels so they may provide a fair return on member capital, or take more credit risk by moving into product lines (e.g. consumer loans or member business loan) that offer higher risks with lower risk adjusted returns. Market realities suggest that the movements of more credit unions into an already crowded and irrationally priced consumer market will likely lead to lower returns (imbalance of supply and demand) and higher losses as ill-equipped credit unions move down the credit spectrum to secure volume. Can the NCUA honestly argue that a high quality three-year ARM (150 percent risk-weighting where portfolio exceeds 35 percent of assets) has higher risk than a three, five or eight year auto loan priced at sub 2.5 percent rates (75 percent risk weighting)? Upon closer examination of this issue, we believe you will see the wisdom of parity with the Basel III guidelines.

The proposed Risk-Based Capital rules will adversely impact members.
The stated mission of the NCUA is to "facilitate the availability of credit union services to all eligible consumers, especially those of modest means, through a safe and sound credit union system." If implemented, the proposed Risk-Based Capital rules will have the opposite effect by harming First Tech and limiting the availability of services we can provide to members. The lower availability of access and credit primarily results from lower risk-adjusted earnings which in turn limits First Tech's ability to reach and serve a larger portion of the U.S. technology sector. All of these adverse results are achieved while offering no tangible benefit to members or reducing risk.

In most instances the proposed risk weights assigned are unduly harsh in comparison with Basel III requirements for banks, and not supported by historical loss levels experienced by well-run credit unions like First Tech. Of particular concern are the risk weights assigned to Credit Union Service Organizations ("CUSOs"), investments, non-delinquent first mortgage real estate loans, and member business loans.

CUSO:
A 250 percent risk weight assignment for all investments in CUSOs lacks any rational support and fails to reflect the actual risk of investing in a CUSO. This risk weighting fails to acknowledge the fact that all CUSOs do not present the same risk metrics. In the case of First Tech, our CUSO invests in well-collateralized performing loans secured by single family homes. The imposition of a 250% risk based capital requirement on this type of asset is inappropriate and highly prejudicial to First Tech's members. Here again, the proposal's "one size fits all" approach to regulation fails to provide considerations for the quality of collateral, operation and risk management activities in the Nation's credit unions and CUSOs. It occurs to us that that NCUA's interest would once again be best served by consistently applying Basel III and using "risk focused" NCUA resources to understand the risk in the CUSO and impose IMCRs as needed. Those players that may have abused the CUSO would cease to do so (or be forced to carry appropriate levels of capital), while those well-managed credit unions could continue to operate with high transparency and appropriate capitalization.

Investments:
The proposed risk weight assignment for investments unfairly penalizes credit unions and shows an unjustified NCUA bias towards lending and against investments. The proposal also discourages the application of well proven "barbell" investment strategies by imposing an unreasonable "cost" toward investment in long-dated securities. The assignments are substantially more punitive than the standardized risk-weight measures for investments that are assigned under Basel III, and fail to accurately reflect the interest rate risk for short-term and middle-term investments such as those under a five (5) year maturity. By example, First Tech holds nearly $2.0 billion of securities which include long-dated mortgage backed securities that are paired off with very short duration insulators. This strategy provides us with modestly higher levels of investment income and very short durations in the total portfolio. The proposed rule will eliminate measurable economic benefit from this type of strategy by forcing us to hold unreasonable levels of capital for long-dated securities (which materially reduces risk adjusted returns) and reduce yields on the Credit Union's securities portfolio while doing nothing to lower interest rate risk. This is yet another example of how "one size fits all" regulation is inappropriate and prejudicial to credit unions and their members. The solution here is for the NCUA to measure quantity of risk and quality of risk management activities verses the current approach of imposing harsh capital levels on credit unions without regard to the quality of risk management protocols or strategies.

Instead of trying to manage interest rate risk and investment risk through risk-based capital requirements, the NCUA may choose to secure examination and supervision resources from the Federal Reserve Banks, Federal Deposit Insurance Corporation, and Office of the Controller of the Currency. These organizations, and the banks they supervise or insure, utilize robust monitoring and management tools that take into consideration the interrelationships between credit, interest rate, investment, and liquidity and concentration risk. While larger credit unions like First Tech currently maintain such systems, small credit unions can secure similar services and insights from CUSOs or other third party providers. This approach would not create a large burden on the industry (other than forcing credit union operators and boards to become better managers) and any burden that is produced will be much lower than the economic and risk management costs of the proposed regulation.

Mortgages:
The NCUA's proposed risk weight assignments unjustifiably double the requirements placed upon banks for non-delinquent first mortgage real estate loans and member business loans. The historical losses suffered by First Tech, and most other credit unions, do not support this excessive requirement. Beyond the argument of the need for fairness and parity with other financial institutions (50 percent vs. 75 percent or 100 percent), the levels contained in the proposed regulations make little sense when the NCUA assigns a risk weight of half as much to an unsecured consumer loan (75 percent), which typically presents a much higher probability and severity of loss, than a secured single family residence.

In the case of member business loans, the assignment of a blanket 200 percent weight fails to recognize the dramatically varying risk dependent upon the purpose and structure of a member business loan, irrationally assigning a risk weight not commensurate with risk (75 percent for unsecured consumer loan versus 100 – 200 percent from a secured business loan or up to 100 percent for a non-delinquent first mortgage real estate loan), as well as loan portfolio diversification benefit derived from member business lending. Regulatory tools exist for the NCUA to control unreasonable risks being taken in both areas. When appropriately managed, both of these classes of loans can provide a credit union with safe means of lending and offering much needed service to its members.

Conclusion

First Tech understands the need for appropriate Risk-Based Capital regulations. The disagreement we have is with the NCUA's chosen methodology in attempting to regulate all credit union risk through this one measure. We strongly believe that this methodology will lead to a weakening of the credit union industry as a whole, specifically curtailing mortgage lending and member business lending; increasing the costs of all loans; decreasing interest that members can earn on their shares in order to support regulation's higher capital requirements; and incenting credit unions to make much riskier unsecured consumer loans in lieu of well secured mortgage loans or member business loans.

The breadth of the proposed Risk-Based Capital regulations is not necessary. Credit unions are already statutorily mandated to carry more capital than their bank counterparts (e.g., leverage ratios for comparable well or adequately capitalized community banks are 40-50 percent less), and sufficient tools exist through the NCUA's current prompt corrective action regulations to craft solutions for individual credit unions that fail to appropriately manage their risks. We believe that a sound "risk focused" supervisory and examination process that holds Basel III capital standards at its core, and is administered by strong, informed and empowered supervisors, will better equip the NCUA with the tools it requires to protect the long-term interests of the credit union industry and strength of the NCUA insurance fund. Imposing capital rules that manage to the least common denominator, or applying a “one size fits all” approach to regulation, is a recipe for failure and a tremendous insult to the thousands of men and women who share the NCUA’s goal of providing a bright and secure future for America’s credit unions and their members. We can and should be better at applying proven approaches that consider the quantity of risk and quality of risk management activities and allow credit unions to remain smart, focused, and competitive.

First Tech appreciates the opportunity to comment on the proposed Risk-Based Capital regulations. Should you have any questions concerning our comments or concerns, please contact me at (650) 386-7220.

Respectfully submitted,

Gregory A. Mitchell
President and Chief Executive Officer
First Technology Federal Credit Union

Cc: Board of Directors
Supervisory Committee