February 10, 2014

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

Alliance Credit Union
Charter: 63789

Commentary Regarding NCUA Risk Based Capital Proposal

Alliance Credit Union has completed an initial analysis of NCUA's proposed risk-based capital rule, which indicates that Alliance Credit Union would fall from being "well capitalized" under the current system to being merely "adequately capitalized" under the proposed system. Please note that Alliance Credit Union's performance over the last decade documents continually rising gross capital.

It is Alliance Credit Union's desire to continue our long practice of being "well capitalized." CUNA estimates that today 68 percent of credit unions with more than $50 million in assets are not just well capitalized, they maintain more than a two-percentage point buffer above being "well capitalized." That percentage would fall to about 62 percent under the proposal. The 6 percent decrease is over and above the almost 10 percent of credit unions that would drop below "well capitalized" under the proposed rule. Alliance Credit Union would drop to "adequately capitalized" under the proposed rule.

CUNA estimates that if all affected credit unions acted to adjust their capital levels to maintain current margins above the "well capitalized" thresholds, they would have to increase capital by several billion dollars. Meanwhile, earnings at credit unions continue to be squeezed by low interest rates, downward pressure on other revenue streams, and moderate, but rising, loan growth. The only other alternative would be to decrease assets by curtailing loans in an attempt to comply with the new rule. This practice would put further pressure on credit unions that already suffer from low to moderate loan to share ratios.

Further, under the proposal, NCUA would assume additional authority to impose even higher capital requirements on individual credit unions that could exceed even well-capitalized level requirements. This is of great concern to us at Alliance Credit Union.

The following analysis is specific to the calculation as it applies to the December 31, 2013 Call Report of Alliance Credit Union. Charter #63789

104(c)(3) Risk-Weights for Off-Balance Sheet Activities

Under the proposed Risk-Based Capital Rule, credit unions are penalized for having unfunded commitments on non-business loans and business loans. In order to improve the risk-based capital calculation, a credit union would look to terminate or decrease those lines of credit to consumers or small business owners.

Consumers need to be able to access these funds whenever they feel it necessary. By turning them off, credit unions in effect would be turning our back on the consumer and our members will go elsewhere for services instead of their credit union. Members need access to these funds for emergencies that they cannot predict. In the event a credit union terminates or reduces these lines of credit to improve their risk-based capital calculation, credit unions have done their members a disservice.

Credit unions promote small businesses in their areas. If this rule is put into effect, they may need to terminate or decrease these lines of credit to improve the risk-based capital ratio. These small businesses need lines of credit for working capital, seasonal needs, or to take advantage of opportunities to further their business. Alliance Credit Union has numerous relationships with small business borrowers that do not use their lines of credit regularly or to the fullest extent of the credit line, but they are comfortable knowing that in the event they need access to quick capital, Alliance is there for them. Under the proposed rule, credit unions may need to terminate these unfunded lines of credit that businesses count on when they need it most.

<u>104(c)(2) Risk-Weights for On-Balance Sheet Assets –Real Estate Loans</u>

Nondelinquent 1st Mortgage Real Estate Loans

The proposed risk-based capital rule provides weightings to nondelinquent 1st mortgage real estate loans based on the percentage of assets of the credit unions. While we do not disagree that there are risks in mortgage lending, the risks can be mitigated in underwriting.

Currently 74% of Alliance Credit Union's mortgage portfolio (1st Mortgages and 2nd Mortgages) is comprised of borrowers with 720 or above credit scores and 89% of the portfolio has credit scores of 680 or above. This would suggest that the portfolio is less risky and thus the weights given in the model should be lessened to account for the decreased risk. The current model does not allow for this. Also, in the recent town hall meeting hosted by NCUA, it was noted that the risk weights were set by how they correspond to the risks of mortgage lending, and more specifically interest rate risk on fixed rate mortgages. The model does not account for Adjustable Rate 1st Mortgages that have less interest rate risk due to re-pricing features.

It would be ideal if the Proposed Risk Weights would be as follows:

Nondelinquent 1st Mortgage Real Estate Loans (excluding Member Business Loans secured by Real Estate)

Total Loans Outstanding	Risk Weight (Fixed)	Risk Weight (Adjustable)
<25% of Assets	0.25	0.125
Excess of 25-35% of Assets	0.50	0.375
Excess of 35-50% of Assets	0.75	0.625
Excess of 50% Assets	1.00	1.00

Credit unions pride themselves on providing affordable mortgage loans to their members. The calculation needs to take underwriting into account that offsets the risk of these mortgages.

Proposed §702.104(b)(1) Capital Elements of the Risk-Based Capital Ratio Numerator

We find that not including the unrealized income on our balance sheet has a material effect on our risk based pricing calculation. We have a relatively low unrealized gain of $534,350 which takes 0.33% off our Risk-Based Capital Ratio. $495,813 of this is due to the unrealized gain on Visa Class B Stock which was given to us at no cost and which we have no control over selling due to pending legal litigation against Visa. We have read over NCUA's rationale behind excluding this from the Numerator and we have also read the FDIC treatment referenced in footnote 42. We do agree that including unrealized gains and losses could "…lead to volatility in the risk-based capital measure, difficulty in capital planning and asset-management and other unintended consequences" as the unrealized gain or loss expands and contracts. We believe the happy medium that would offset the effect of the unrealized gain and loss would be to net the gain or loss against the investment which created it, which would basically mean valuing the investment at book. This would make adjustments to the unrealized gain or loss; haveing no net effect on the calculation. The way the proposed regulation is written an unrealized gain would increase the value of the investment in the denominator and an unrealized loss would decrease the value of the investment in the denominator. While the effect is much less in the denominator due to the denominator being a much larger number compared to the numerator, the volatility is still there. Also with an unrealized loss there is no deduction from net worth and the asset is still decreased on the risked based asset calculation, a large unrealized loss could hide a risk that the net worth would have to be reduced if the credit union was liquidated. For these reasons, we believe the best option with regards to actual risk and reducing volatility would be to net the unrealized gain or loss against the investment that created it and report the investment at book. Doing so on our balance sheet would change our ratio by 0.06%.

Proposed §702.104(b)(2) Risk-based Capital Numerator Deductions

We were shocked to see that the NCUSIF Share Insurance Capitalization Deposit was subtracted from our net worth in this calculation. We have read the rationale in the proposed regulation and we fail to see anything in the rationale about the risk to credit unions. The paragraph regarding the NCUSIF Share Insurance Capitalization Deposit just says it will address concerns about the NCUSIF's balance sheet and that it wouldn't change the accounting treatment of the deposit for credit unions. We believe that subtracting it from our net worth says that we shouldn't expect that money back at any point since it is not available to cover any of our risks or losses. We think that saying this treatment will not alter the accounting treatment is wishful thinking at best. If the funds are not available to cover our risks during liquidation then that leads to the question of whether or not it is an asset. If it is not an asset then each credit union should expense those funds and post any adjustment for an increase or decrease in insured shares as an expense or contra expense depending on the situation. I think we can all agree that expensing the NCUSIF Share Insurance Capitalization Deposit isn't the answer. We think it should be looked at as an investment, much like the Federal Home Loan Bank stock that many credit unions have and treated as such. This would mean assigning a risk weight to account for the possibility of the fund having to use the credit unions funds beyond the normal premiums and losing some of the equity we have in the NCUSIF. We believe that leaving the NCUSIF Share Insurance Capitalization Deposit on the balance sheet, assigning a risk weight, and removing the deduction from net worth, is the best option in regards to measuring the ability of each credit union to weather losses.

In conclusion, Alliance Credit Union believes that NCUA has not adequately justified the need for this rule. Alliance will continue analyzing all aspects of the proposal. We urge NCUA to do the same. We also believe that substantial time will be necessary to implement changes which will eventually bring many credit unions into compliance with any new regulation of this nature.

Timothy F. Stephens

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Timothy F. Stephens
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Alliance Credit Union