April 24, 2015

Gerald Poliquin
Secretary of the Board
NCUA

Via Email Comments on NCUA Risk Based Capital Proposal RIN 3133-AD77

Dear Mr. Poliquin,

As Chairman Matz has taken credit for on many occasions "**Our capital was strong enough to carry us through the greatest financial crisis… we did not take a penny of TARP money**". This is a validation that the current capital structure was adequate to handle the worst financial crisis since the great depression. After examining the numbers we had additional reserves to handle an even more significant impact. The banks were not as prepared as we were. Setting aside their poor stewardship and lending practices, they chose to reward their stockholders with dividends and their executives with outrageous compensation packages while we constructed a strong defense to protect our members from a financial calamity.

My first comment focuses on the business case for change. There is no logical reason to change our capital structure requirements. The system did exactly what it was designed to do. If there is a mandate from congress to be structured in a similar way, then FDIC should conform to our model; the one that was successful. My understanding of the direction Congress gave was to keep focus on the Cooperative Nature of Credit Unions as you establish any new rules and I see no evidence of this in the proposed rule.

230 Walnut St. Danville, PA 17821 1-800-834-0082 (f) 570-275-4176 www.mcfcu.org

When you couple the strong industry capital credit unions hold with the changes that were legislated to prevent the things that caused the collapse from happening again, there is again no reason to change our capital structure. One would conclude we are in a safer position because the triggers that drove the failures in banks have been addressed. Dodd-Frank has been crafted to address specific drivers to the collapse. I tried to probability rate the events happening that drove the collapse and could not assign a percentage. If I had to make an educated guess based on the changes in the regulations I would have to say slim to none. The congress assured us that this will not happen again and took actions to ensure it does not.

I represent Members Choice Financial Credit Union, formerly M-C Federal Credit Union, with $125 million in assets. We are a rural seg based Credit Union with a few underserved census areas in our field of membership**. We have developed a strategic plan that has identified the key balance sheet composition to successfully operate a small credit union in a rural environment where the seg is our primary membership driver. Absent in this rule is the critical point that field of membership composition and size have a dramatic impact on Strategy and Balance Sheet development.**

Let me illustrate with an example. We have 11,000 members of which many of them are home owners. Our strategy was to hold mortgages at a defined level to create a balance sheet that strategically delivers a return strong enough to support the business and build capital. Our mortgage portfolio is a critical component of the balance sheet loan mix. Why is this so critical? In our market it is an appreciating asset. Every payment delivers a stronger collateral position. The yield is strong with a strong spread to our cost of funds. We hold our fixed rate mortgages as a part of our rural SEG based balance sheet. This is a critical element of an optimum loan mix that provides safety and security to our members and reserves. This rule will force us to change our strategy and sinfully manage our business to achieve a capital number not to serve our members.

Perhaps if I were a community credit union in a metropolitan area a sell strategy may work best to manage risk; but that is not my credit union. I need to make 10

$20,000 auto loans to equal one mortgage of $200,000. Lending at 80% as we do, this is a great loan. In 2009 we had our most profitable year based on this balance sheet strategy. My IRR is low based on our NEV model and my loan loss for mortgages is zero**. The point is that this rule will hurt my credit union and execution of our strategy by assigning higher risk based capital requirements because we hold core real estate loans that are a critical part of our loan portfolio.**

In your rule making you assume that one solution is the answer for all credit unions. This proposal is a prime example that it will have a greater impact on the small rural credit unions. Remember being seg based I have a limited number of potential members, and being rural the population density is less so the mix of loans is important. Compared to a community credit union in the city where anyone can get a mortgage, the fee income leveraged by the volume works best for them. I support an exemption for credit unions under $500 million in assets because the rule has negative financial implications.

The risk assignments are arbitrary. This proposal references the bank model as a validation upon which risk weight assignments are set. Within the proposed capital risk structure there appears to be a link between asset life and risk. Director Fazio has gone on record that asset life (NLTA) is not an indicator of risk, specifically interest rate risk**. My conclusion is that there is no empirical data used to support the risk weight ratings. Using the" worldwide bank look alike" mythology does not mirror the risk I have in central Pennsylvania or the risk of many other peers' credit unions.**

How was the risk levels developed? In your rule you make mention that they are consistent with worldwide risk weights of depositary institutions. I hope that this is a miscommunication and we are not following their ship. Assuming there was a business case for change, you had an opportunity to develop risk profiles that are relative to our data. Any comparison to international depositary numbers does not give me comfort. This is our capital to protect and we have done a fine job.

We hear about transparency in the agency however a question as simple as how was the risk rating formulated goes unanswered. This was clear with RBC1 and is still present in RBC2.

This would be something that I need to understand. Our experience is that asset life is not a good indicator of interest rate risk just as Director Fazio has stated.

Commented [W1]: I changed this since you mentioned 3 paragraphs above that he went on record.

Addressing Interest Rate Risk under a separate rule concerns us greatly. History is our strongest advocate when I state that **no credit union has failed because of interest rate risk**. The analysis of 100, 200, 300, 400 basis point shocks is inconsistent with the way the financial system works yet it is the standard for analysis and decision making. Looking back at the last period of rise in rates the pattern showed that rate behavior was significantly less than the shocks in intensity and duration.

IRR is part of the risk we manage and it should be covered in our capital requirements rule. Chairman Matz has publically announced that the biggest risk we face is interest rate risk. This proposal, our risk safety net, becomes disconnected form interest rate risk. **I have a concern that by isolating IRR outside of this proposal it opens the door for another hurdle so when you aggregate the requirements it will raise the bar to an even higher level. Our capital safety net should be designed to protect us from all risks.** I have concerns that separating the IRR element of risk from our capital requirement will amount to an increase that is disguised under another name.

During the financial services collapse we were able to build our capital from 6.79% @ $107.373 million in assets to 8.83% @ $124.702 million in assets. The capital growth calculates to 30.04% with asset growth of 16.14%. During this period we grew assets to $137 million or 27.59% and strategically reduced them to the current level to align with loan demand. **This strong capital growth in the worst financial time we have experienced since the great depression was achieved through a balance sheet strategy that was developed based on our rural FOM composition, non-time deposit history, and safety and soundness.**

Risk levels increase when the concentration is higher in your proposal. The logic is confusing. If I write two mortgages based on the same strong lending criteria they may hold different levels of risk. I make the loans based on specific criteria with the objective of making a good loan that the member can pay back. Assigning a higher risk level based on concentration puts smaller institutions in an uncompetitive position and hampers their ability to serve members. This will cause us to manage to a number instead of managing to serve our members. If you did a root cause analysis of credit unions that have failed, how many failed because of real estate concentration? **Let's not confuse poor lending with concentration.**

In the example above our mortgage position was beyond the 35% of assets and you would have accessed a higher risk based capital requirement forcing us to possibly curtail lending because of your arbitrary assignment of a threshold. I hold to the premise that a good loan is great and 50 good loans are even better. My risk on these loans are determined in my ALLL reserve based on a lot of specific environmental factors in my market and should not carry an additional capital burden just because of the volume.

As our regulator you should know better that any of us that the snapshot you present today will be different next year, as it was different from five years ago. To down play the number of credit unions that will be impacted by this rule as insignificant is a misstatement of fact. **The fact is that we will all be impacted by this rule. Using the well capitalized shield in your comparison is misleading. That designation is a result. It is a result of strong stewardship as we carry out our mission to serve our members.** At the core if this rule is implemented, we will all have to change our business models and strategy to manage to your number. Our strategic plan has a bull's eye painted on it. It has served our members well and increased safety and security but this RBC2 rule will cause us to stop. We will have to change our MBL strategy as the growth we have in our strategic plan will hurt our risk capital position. We will have to change our hold mortgage strategy as it will change our risk capital position. The rule is a killer for the small rural seg based credit union who has growth in their future.

Our Credit Union is complex under the current rule and we have successfully managed through this crisis. The key word is managed. I would suggest that if you want to equate complexity to size that is a bad comparison. If your intent is not to burden smaller credit unions with this rule for the fear they would be significantly impacted, then move the exemption to $500 million. It will have the desired impact at that level.

As you developed your proposal there is an assumption that all credit unions are the same. The same FOM composition, no geographic or demographic deviations, and that size have no bearing on the rule. This simple approach yields a result that will cripple a class of credit unions, one of which I represent.

Sincerely,

Jim Barbarich
President / CEO
Members Choice Financial Credit Union