April 24, 2015

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

Re: Comments on NCUA's Risk Based Capital (RBC2) Proposal

Dear Mr. Poliquin:

On behalf of First Source Federal Credit Union, I am providing the following comment letter regarding the National Credit Union Administration's proposed risk-based capital rule, as revised, that was recently approved by the NCUA Board. We appreciate the opportunity to express our concerns about the potential negative impact of the proposed rule on credit unions and to offer some suggested improvements in the rule as the NCUA finalizes the rulemaking process.

History indicates that credit unions have demonstrated their ability to manage their financial condition under very adverse economic circumstances and continue to effectively manage and mitigate risk as evidenced by an industry-wide average Net Worth of just under 11% as of December 31, 2014. NCUA's regulation and supervision under existing rules has played a part in this outstanding financial performance. However, despite this performance versus the most demanding capital standards currently in place for any sector within the financial services industry, the NCUA's proposed risk-based capital proposal would impose an even higher and unnecessary risk-based requirement on top of the 7% leverage ratio we are currently required to maintain by statute in order to be considered well-capitalized.

Since the credit union industry has a limited ability to raise capital other than through retained earnings and because the most severe financial crisis since the Great Depression did not provide any compelling evidence pointing to the need for greater capital reserves in credit unions, we believe the one-size-fits-*all* categorical approach outlined in this proposal is both burdensome and inequitable. While First Source FCU is supportive of the concept of a Risk Based

Capital structure for credit unions, we do not believe this proposal is appropriately balanced, equitable, or necessary.

If credit unions with riskier balance sheets are required to maintain more capital, then credit unions with more conservative and less risky balance sheets – as well as those that have proven their ability to manage the risk in the balance sheet - should benefit by having a lower required risk-based capital level.

We believe there would be several unintended consequences of the risk-based net worth proposal in its current form such as, but not limited to, higher lending costs, lower dividends to consumers and forcing credit unions to curtail mortgage and member business lending activities. The proposed rule in its current structure may very well produce long-term adverse effects on credit union growth, forcing many credit unions to realign their balance sheets when it is not justified by solid asset-liability risk management considerations and significantly alter their strategic objectives.

Higher capital requirements beyond those justified by the balance sheet risk will inevitability reduce the availability of funding for credit unions to invest in strategic growth initiatives. Capital reserves currently available for branch expansion, technology, new products/services and investment in innovation will no longer be available for credit unions as these dollars will have to remain in reserves. When credit unions lose access to their additional capital reserves and are required to operate under a regulatory mandate that effectively defines how their balance sheet must be structured, all credit unions (regardless of their risk profile) will be adversely impacted.

We appreciate NCUA's willingness to listen to industry concerns and to make some very positive changes to the original RBC proposal. We commend the agency for these needed changes, which include extending the implementation schedule, raising the "complex" threshold, revising a number of risk weights to remove the interest rate risk component, lowering risk weights on certain real estate secured loans, raising the concentration limit risk weight trigger on business loans and mortgages, eliminating the cap on the inclusion of the allowance for loan losses, and removing the provision that authorized an examiner to subjectively change a credit union's capital requirement.

In our view, despite the revisions made to the original proposal, the new proposed rule will still put credit unions at a competitive disadvantage which will ultimately negatively impact consumers and small businesses across the country. Credit unions are already at a competitive disadvantage to the banking industry in terms of capital requirements and this proposed rule magnifies that disadvantage by requiring credit unions to unnecessarily hold additional capital. It will, in its current form, adversely impact the value of the credit union charter.

We believe the following areas that were weaknesses in the original proposal were not sufficiently addressed and or revised in the current proposed regulation:

- Risk-Based Capital Ratio Thresholds
- Risk-weighted Assets in CUSOs
- Supervisory Assessment of Capital Adequacy
- Concentration Risk Thresholds
- Plan to address Interest Rate Risk
- Supplemental Capital
- Need for a Legislative Solution for Risk-Based Capital

Risk-Based Capital Ratio Thresholds

The proposed rule would introduce a 10% risk-based capital threshold for a complex credit union to be well capitalized and an 8% risk-based capital threshold for a complex credit union to be adequately capitalized.

Banks can satisfy their total risk-based capital using a combination of Tier 1 and Tier 2 capital at a lower percentage than 10% to be considered well-capitalized. Credit unions, however, do not have the ability to engage in all the available Tier 2 capital instruments. Instead, credit unions must satisfy their capital requirements with elements more similar to a bank's Tier 1 capital. While the proposed rule would allow credit unions to count ALLL towards their risk-based capital ratios, it would still not permit all credit unions to count secondary capital toward the RBC requirements. We recommend that a single-tier threshold requirement of 8% would align better with the bank's Tier 1 capital requirements.

Risk Weighted Assets in CUSOs

While First Source FCU has not invested significant resources in Credit Union Service Organizations, we believe in the CUSO model for collaboration and efficiency. There is a greater need in our industry for economies of scale and operational efficiency that can be gained via a CUSO. We believe the revised proposed risk-weighting of 150% is still too high and will discourage credit unions from seeking these cost savings by participating or investing in a CUSO.

While there may have been less than a handful of high-profile credit union losses caused in part by improperly managed CUSO investments, the record continues to demonstrate that the overwhelming majority of CUSOs are performing very well, earning needed income and generating considerable savings through economies of scale. The proposed rule very well may force credit unions to reconsider current and future investments in CUSOs and drive them to other sources outside the industry where there is considerably more risk - again putting credit unions at a competitive disadvantage that could ultimately lead to potential safety and soundness concerns.

The risk-weighting for a CUSO investment still appears to be particularly arbitrary, without support from any historical data, and may not at all reflect the actual risk of investing in a particular CUSO. Consideration should be given to the low systemic risk of these organizations in our industry. We believe the best approach would be to weight all CUSO investments at 100% to be consistent with the FDIC system.

Supervisory Assessment of Capital Adequacy

The proposed rule would require "complex" credit unions to maintain a comprehensive written strategy appropriate for their level of capital and risk profiles. During the supervisory process, NCUA would assess whether these written plans adequately address a credit union's activities and risk profile, as well as risks and other factors that can affect its financial condition. NCUA's supervisory assessment will also take into account the quality and trends in a credit union's capital composition and whether the credit union is entering new activities or introducing new products.

We appreciate the removal of the general individual minimum capital requirement from the first proposed rule; however, the revision does not go far enough. We believe that Congress never intended for NCUA to implement any form of individual minimum capital requirements, either through the rulemaking or examination processes.

This modified provision still gives NCUA the authority to subjectively increase a credit union's capital requirement above the 8% or 10% of risk based assets. It is especially troublesome and should be eliminated from the final rule. If adopted in its current form, this provision would make it practically impossible for a credit union to make sound business decisions relative to its portfolio mix, leading to uncertainty for credit unions. The final rule must establish capital requirements that a credit union can manage effectively. An arbitrary, movable threshold is virtually impossible for a credit union to utilize as an effective management criteria in developing its strategies.

Concentration Risk Thresholds

The proposed rule uses a tiered risk-weight framework to require incrementally higher levels of capital as a credit union's concentration in residential real estate, home equity, and commercial loans increases. The reasoning includes the assessment that credit union failures and NCUSIF losses were caused by these concentrations.

We do not believe that either the historical data or the reviews of failed credit unions supports the correlation between these concentrations and credit union failures. We also feel strongly that since the banking regulators do not include these concentration risk thresholds in their risk weights, this runs counter to the intentions of Congress for a fair system. Credit unions would be at a significant competitive disadvantage if they are included in the final rule. Just as the revised proposal chose to address interest rate risk through the supervisory process and outside the RBC rule, the same approach should be taken with concentration risk.

Plan to address Interest Rate Risk

NCUA has indicated in the revised proposed rule that they are considering an alternative approach to interest rate risk, and specifically seeks comment on how it can reasonably account for it in the future. We believe that interest rate risk can be addressed through continued application of existing methods as part of the current supervision and examination process, rather than a separate regulatory standard.

NCUA already has a number of requirements and guidance regarding interest rate risk. Part 741 requires federally-insured credit unions to develop and adopt a written policy on interest rate risk and a program to effectively implement that policy. NCUA also issued a supervisory letter to credit unions, 12-CU-05, advising the industry of widely accepted sound practices. Interest rate risk has also been included in the most recent supervisory focus letters (14-CU-01 and 15-CU-01).

Bank regulators evaluate for interest rate risk through their annual examination process by ensuring that banks maintain sufficient capital for interest rate risk. Existing NCUA supervisory and examination mechanisms provide it the same authority to ensure that credit unions have enough capital to absorb the level of interest rate risk on their balance sheets. If NCUA were to create an additional rule, it would hold credit unions to a significantly different standard than banks. Therefore, since existing supervisory and examination mechanisms provide the agency the ability to control interest rate risk at individual credit unions, we believe inclusion in the RBC is inappropriate and that a separate rulemaking on IRR is not necessary.

Supplemental Capital

The proposed rule does not provide any changes that would allow credit unions the authority to raise supplemental capital. Any consideration to changes in capital requirements for credit unions is incomplete without this discussion. Supplemental capital in the form of subordinated debt is needed now more than ever considering the restrictions that will occur if the risk-based proposal is adopted in its current form. NCUA should call upon Congress to pass a legislative solution to modernize capital standards and direct NCUA to design a risk-based capital regime that takes into account material risks.

In the meantime, NCUA should count and appropriately weight supplemental capital as part of the risk based capital structure for those low-income designated credit unions authorized to have supplemental capital and also enact and implement a supplemental capital regime for all credit unions before the effective date of the RBC rule.

Need for a Legislative Solution for Risk-Based Capital

While we support a risk-based capital system for credit unions that would reflect lower capital requirements for lower-risk credit unions and higher capital requirements for higher-risk credit unions, we believe that the current proposed rule has inconsistencies with the intentions of Congress and the Federal Credit Union Act. There are deviations from the statutory requirements for PCA without the needed legislative changes.

This additional capital buffer will result in credit unions making fewer loans to their members. Credit unions must also account for a one percent contribution to the NCUSIF which constructively limits the amount of funds available for credit unions to extend credit, placing additional capital burdens on credit unions.

The Federal Credit Union Act requires that credit unions have net worth ratios of six percent to be considered adequately capitalized and seven percent to be well capitalized, while banks have leverage ratios of four percent to be adequately capitalized and five percent for well capitalized. Credit unions are already at a competitive disadvantage to banks in this regard, and this proposed rule will only compound this issue by requiring credit unions to hold even more capital than banks. We believe that NCUA should first work with Congress to change prompt corrective action requirements such that credit unions are put on equal footing with other financial institutions. Once this is accomplished, the RBC rule can be appropriately addressed and finalized within the definitions of that statutory change.

Conclusion

Thank you for the opportunity to comment on this proposed regulation. Again, we support the efforts of the NCUA to pursue a balanced risk-based capital system that requires additional capital for truly higher risk credit unions while rewarding those credit unions with proven risk management evident in a lower risk balance sheet. We also thank the NCUA for listening to credit union comments and feedback as reflected in the substantive changes that have been made in the revised version.

First Source FCU urges NCUA to withdraw the proposed rule and work with the industry and Congress to modernize capital standards for the credit union industry. While we do not believe the current proposal is sufficiently balanced and should be withdrawn if it cannot be perfected, we respectfully encourage

NCUA to consider the recommended improvements to the proposal in the event the agency determines that it is not prudent to withdraw the proposal in its entirety. It is absolutely crucial for the long term viability of the credit union industry and the value of the credit union charter that NCUA do everything reasonably within its power to make sure this final rule is balanced and appropriate to the risks reflected within credit unions' capital structure.

Very truly yours,

Thomas Neumann
Executive Vice President/COO