FINANCIAL RESOURCES
FEDERAL CREDIT UNION

April 27, 2015

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

RE: RIN 3133-AD77 Comments on 2nd Proposed Risk-Based Capital Rule – RBC2

Financial Resources Federal Credit Union, formerly the Ethicon Employees Federal Credit Union and the Raritan Federal Credit Union, was formed over 75 years ago and currently provides a variety of financial products and services to almost 20,000 members with total assets over $400 million.

The second proposed rule, RBC2, is an improvement over the original proposal NCUA issued last year and addressed many of our comments; however, the following four areas warrant further comments/review:

- **Risk Weighting** of (1) Real Estate Loans, (2) Commercial Loans, (3) Investments in Credit Union Service Organizations (CUSOs) and (4) Mortgage Servicing Rights (MSRs)
- **Interest Rate Risk** (IRR)
- **Supplemental Capital**
- **Implementation Period**

Risk Weighting

Below is a table that summarizes risk weighting on six types of assets, including RBC2 and our suggestion to the final rule:

Asset	% of Assets	NCUA RBC2 Risk Weighting	FDIC/**Suggested** Risk Weighting
1st Mortgage	>35%	75%	50%
Home Equity Current	>20%	150%	100%
Home Equity Non-Current	N/A	150%	100%
Business Loans	>50%	150%	100%
Investment in CUSOs	N/A	150%	100%*
MSRs	N/A	250%	<= 150%*

*Represents suggested risk weighting only, not FDIC/bank risk weighting

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Risk Weighting of Loans

The proposed RBC2's risk weighting remains too high for first lien residential mortgage loans, junior lien residential mortgage loans and commercial loans. The proposed weighting on these three types of loans exceeds risk weights for banks, which would require more capital for credit unions. These risk weights inappropriately apply higher levels of risk to credit unions versus banks, which is contradictory to historical loan loss rates that indicate lower risk for credit unions. Under the proposed RBC2, the NCUA is placing the credit union industry at a disadvantage to the banking industry. This disadvantage will likely translate to higher product costs (loan rates) and lower returns (dividends) to members, or both.

Recommendation: Final rule to use same risk weighting as banks for loans: (a) current 1st lien residential real estate (1st Mortgage) loans over 35 percent of assets to risk weight at 50 percent, (b) current junior lien real estate (Home Equity) loans over 20 percent of assets to risk weight at 100 percent, (c) non- current junior lien real estate (Delinquent/Non-Current Home Equity) loans to risk weight at 100 percent, and (d) current commercial (Business) loans over 50 percent to risk weight at 100 percent.

Risk Weighting for Investment in Credit Union Service Organizations (CUSOs)

The proposed RBC2 has reduced CUSO loans to 100% risk weight and CUSO investments to 150% risk weight. Investment in CUSOs risk weighting is still too high and doesn't reflect that actual risk of investing in CUSOs. A proper assessment of the risk associated with a CUSO would analyze the history of profitability, whether the investment amount has been fully recovered by the credit union through savings or income, and the level of risk associated with the activities provided by a CUSO. Many credit unions are utilizing CUSO relationships to consolidate functions in an effort to provide specialized services to members, reduce operating expenses and/or offset declining income levels.

Recommendation: CUSO investments should have the same 100 percent risk weighting as CUSO loans. Any exceptions to potential credit union risk should be managed through the examination and supervision process and not by a system-wide capital regime.

Risk Weighting for Mortgage Servicing Rights (MSRs)

The second proposed rule remains unchanged at a 250% risk weight for mortgage servicing assets which is punitive. In 2013, NCUA finalized a rule on loan participations that was intended to help credit unions and NCUA better manage the potential concentration risk in loan participations. Credit Unions should be allowed to continue utilizing this rule instead of implementing higher risk weights for mortgage servicing assets. In addition, NCUA could consider whether the loan is a recourse loan and assign those a higher risk weight and allow an even lower weighting if loans are sold without recourse.

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An important tool in managing interest rate risk along with the member relationship is the sale of long-term fixed rate mortgage loans into the secondary market while maintaining the servicing of the loans. The 250% risk weighting however contradicts and discourages this practice and may encourage not selling loans or selling related loan servicing (the member relationships) with the loans. As far as volatility concerns, Financial Resources FCU measures MSRs using the fair value method and reports changes in fair value of servicing assets in earnings in the period in which the changes occur.

Recommendation: To reduce the risk weighting on MSRs to a maximum of 150 percent. To incorporate recourse into the equation when determining the risk weight and allow a lower weight of 100 percent if the loans are sold without recourse but are still serviced.

Interest Rate Risk (IRR)

In the proposed RBC2, the NCUA is requesting comments on approaches to reasonably account for IRR as a component to the RBC rule. ***Financial Resources FCU is opposed to adding an interest rate risk component to the Risk-Based Capital rule***. The results of overburdening credit unions with a new and complicated IRR approach will likely require standardized assumptions and approaches to assumptions which will ignore the unique risk of an individual credit union. This could potentially minimize or eliminate examiners and credit union decision makers (management and volunteers) from the ability to quantify and understand the unique risks of an individual credit union.

Over the last several years, NCUA has issued numerous rules and letters addressing the issue of IRR with NCUA imposing different requirements on federally insured credit unions depending on their asset size. Such requirements include the development and adoption of a thorough written policy on IRR management and a program to effectively implement IRR as part of asset liability management (ALM) responsibilities. Our ALM/IRR policy appropriately addresses responsibilities of board and management, IRR measurement and monitoring, internal controls and integration of IRR into decision making.

In summary, there is no need to burden credit unions with a new one-size-fits-all IRR approach. Standardization does not change the need to understand the unique risk of our Credit Union, and to continue to manage/analyze IRR based on our extensive ALM/IRR policy.

Supplemental Capital

The proposed RBC2 includes a list of questions relating to additional supplemental forms of capital, and specifically requests comments which we have addressed as follows:

Q: Should additional supplemental forms of capital be included in the risk-based capital ratio numerator and how would including such capital protect the NCUSIF from losses?
A: Yes, ***allowing credit unions to issue supplemental capital would increase total capital and allow alternate funding resulting in a stronger liquidity position***.

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Q: What criteria should be required?
A: ***Supplemental capital for well capitalized credit unions should count toward both net worth ratio and risk-based net worth, subject to limits given maturity and risk considerations***. Examples of specific limits related to maturity and risk can be found in the NCUA Supplemental Capital White Paper dated April 12, 2010.

Q: What additional changes to NCUA's regulations would be required?
A: Supplemental capital cannot be included in net worth for most credit unions without a change in federal law; ***therefore it is strongly encouraged that NCUA pursue enactment of legislation that would authorize the use of supplemental capital as net worth***.

Q: What investor suitability, consumer protection, and disclosure requirements should be put in place?
A: ***Robust, transparent and full disclosures including periodic reminders that a supplemental capital account is uninsured***. See NCUA Supplemental Capital White Paper dated April 12, 2010 for detail.

As stated in our first comment letter, a credit union's net worth is currently based solely on retained earnings. Allowing federal credit unions access to secondary or supplemental capital is a more constructive approach to achieving capital objectives than shrinking assets/deposits.

Recommendation: To permit the use of supplemental capital for risk-based capital in the final rule, and to encourage Congress to enact legislation to allow the use of supplemental capital as net worth.

Implementation Period

The proposed RBC2 implementation period is January 1, 2019, however, we encourage the agency to delay implementation even further to coincide with the termination of the corporate stabilization fund, at which time credit unions will likely receive refunds (based on most recent projections of TCCUSF surplus). The refunds will be important to those credit unions that will need to increase capital levels in order to comply with RBC2.

Recommendation: Extend the implementation period to a time period to 2021 to coincide with the termination of the corporate stabilization fund.

Thank you for the opportunity to comment on the second proposed risk-based capital rule.

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