American Heritage
FEDERAL CREDIT UNION

April 27, 2015

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

Via email to regcomments@ncua.gov "AmHFCU – Comments on Proposed Rule: Risk-Based Capital; RIN 3133-AD77"

Dear Mr. Poliquin,

American Heritage Federal Credit Union (AmHFCU) appreciates the opportunity to comment on the National Credit Union Administration (NCUA) Board's second proposal to revise Prompt Corrective Action related to Risk-Based Capital (Second Risk-Based Capital proposal). AmHFCU is a low-income designated credit union serving the county of Philadelphia, PA as well as 800+ select employee groups in Pennsylvania. We have 136,000 members and $1.5 billion in assets.

Overall, the Second Risk-Based Capital proposal will have a negligible effect on AmHFCU members and not discourage investment in long term strategies necessary for the continued growth of the credit union, as the original proposal had. Under the original proposed risk-based capital rule, AmHFCU would have seen its well-capitalized buffer fall 99%, to $341,000 from $34,762,000. Under the Second Risk-Based Capital proposal, AmHFCU would see its well-capitalized buffer increase 24% to $43,127,000 from $34,762,000. However, AmHFCU is requesting NCUA to still consider changes as more detailed below.

Cash Held at the Federal Reserve

Proposal: The Second Risk-Based Capital proposal assigns cash held at the Federal Reserve a 0% risk weighting.

Comments: We agree with the change in the risk weighting to 0% from 20% as we had recommended in our first comment letter response.

Recommendation: None.

Investments

Proposal: The Second Risk-Based Capital proposal assigns guaranteed investments no risk-weight and for the remaining securities uses credit risk to assign risk-weight as noted below:

- For NCUA or FDIC investments, the proposed risk-weight is 0 percent.

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- For US Government investments, the proposed risk-weight is 0 percent.
- For uninsured deposits at US financial institution, the proposed risk-weight is 20 percent.
- For Agency obligations, the proposed risk-weight is 20 percent.
- For FNMA and FHLMC pass-through MBSs, the proposed risk-weight is 20 percent.
- For general obligations issued by States or Political Subdivisions, the proposed risk-weight is 20 percent.
- For FHLB Stock and balances, the proposed risk-weight is 20 percent.
- For senior Agency residential MBS or ABS Structured, the proposed risk-weight is 20 percent.
- For revenue bonds issued by States or Political Subdivisions, the proposed risk-weight is 50 percent.
- For senior non-Agency residential MBS or ABS Structured, the proposed risk-weight is 50 percent.

Comments: We are pleased with the changes made to remove the weighted average life definition and focus on credit risk, and to make the risk-weightings comparable to FDIC rules.

Recommendation: None.

Investments in Federal Home Loan Bank

Proposal: The Second Risk-Based Capital proposal assigns Investments in Federal Home Loan Bank a 20% risk weighting.

Comments: We agree with the change in the risk weighting to 20% from 50% as we had recommended in our first comment letter response.

Recommendation: None.

Non-Delinquent Real Estate Loans

Proposal: The Second Risk-Based Capital proposal uses non-delinquent, defined as greater than 90 days, real estate loan concentrations to establish risk-weights as follows:

- For first lien residential real estate <35% of assets, the proposed risk-weight is 50 percent.
- For first lien residential real estate >35% of assets, the proposed risk-weight is 75 percent.
- For junior lien residential real estate <20% of assets, the proposed risk-weight is 100 percent.
- For junior lien residential real estate >20% of assets, the proposed risk-weight is 150 percent.

Comments: We agree with several of the changes including:

- the change in definition of non-delinquent loans from 60 days to 90 days delinquent,
- the removal of the 25% tier within the concentration of first lien residential real estate,
- the removal of the 10% tier within the concentration of junior lien residential real estate,
- the inclusion of junior loans in a first position as a first lien residential real estate loan with reduced proposed risk-weighting requirement,
- the inclusion of 1-4 family non-owner occupied first and junior lien loans as first-lien residential real estate loans with reduced proposed risk-weighting requirement,

Also important to AmHFCU is our strategy to mitigate interest-rate risk through on-balance sheet hedging strategy of borrowing advances from the Federal Home Loan Bank in a matched-book strategy. We had significant comments in this area. We agree with the removal of the interest-rate risk component from the Second Risk-Based Capital proposal.

The risk-weights also do not take into consideration any of the following factors that could indicate that the loans are more or less likely to be collected, including

- the loan-to-value ratio of loans, or
- the credit scores of members, or
- salability of loan to secondary mortgage participants (DU eligible or not), or
- size of loans, such as jumbo mortgages.

These factors should be used to lower the amount of capital required to be held for loans that are safer than others. We notice that none of these factors are contained within the Second Risk-Based Capital proposal.

Lastly, we appreciate the broad alignment with comparable FDIC weights for similar components.

Recommendation: Further consideration should be performed to incorporate loan-to-value ratios, credit scores of members, salability of a loan to secondary mortgage participants and the size of loans in the proposed risk-weighting.

Loans Held for Sale

Proposal: The Second Risk-Based Capital proposal appears to be silent with respect to the risk-weight for loans held for sale.

Comments: In the original proposal, the risk-weighting for loans held for sale was 100%. In the Second Risk-Based Capital proposal, the risk-weighting for loans held for sale appears to be silent, therefore, we will assume that they are to follow the risk-weighting for the type of asset category of the loans. AmHFCU and our majority-owned subsidiary, First Heritage Financial LLC, originate some mortgage loans with the intent of selling them within 30 days. On the call report, these loans are categorized as held for sale. The loans are underwritten to secondary market underwriting standards of Federal Housing Association, Federal National Mortgage Association and United States Department of Agriculture prior to closing, the same as our first mortgage loans held to maturity. Since they are sold within 30 days and carry no greater risk than first-lien residential real estate loans that are classified at 50%, the risk-weighting should be less than 50%. Loans held for sale are typically less than one-half of one percent (1/2%) of our balance sheet.

Recommendation: We recommend a risk-weight for loans held for sale at 25%.

Member Business Loans / Commercial Loans

Proposal: The Second Risk-Based Capital proposal removes Member Business Loans from its calculation and replaces it with a proposal for Commercial Loans, and sets the risk-weights to correspond with the percent of assets held by the credit union as follows:

- Commercial loans < 50% of assets are weighted at 100 percent;
- Commercial loans > 50% of assets are weighted at 150 percent;

Comments: Approximately four years ago, AmHFCU was classified with a low-income designation serving the needs of the county of Philadelphia, the fifth largest city and the fourth largest metropolitan area within the United States. As a result, we are exempted from the aggregate loan limit for MBL's. It is our belief that being designated as a low-income credit union meant that the government wanted us to lend to our marketplace and reinvigorate the economic area we serve. The proposed risk-weights will not restrict that goal as much as the first proposal had but still does not incorporate credit risk.

The commercial loans that we have within our portfolio consist of credit cards, share secured, automobile, truck, bus, equipment, strip malls, and other "less risky" loan types than a multi-story commercial building or working capital loans. The Second Risk-Based Capital proposal does permits 1-4 family residential commercial loans to be treated as 1-4 family residential real estate loans at a reduced risk weighting, with which we agree with this change. But more should be done.

Recommendation: Using the classification within the current call report, we would proposal the following weightings:

	< 50% of assets	>50% of assets
Credit card	100%	150%
All other unsecured/LOCs *	100%	150%
New Vehicle	50%	75%
Used Vehicle	75%	112%
1st Mortgage Loans/LOCs **	75%	112%
Other Real Estate Loans/LOC **	100%	150%

* Including taxi-medallion loans

** Other than 1-4 family residential commercial properties either in a first position or first and second position

CUSOs

Proposal: The Second Risk-Based Capital proposal would set the risk-weight at 150 percent for an investment in an unconsolidated CUSO and 100 percent for loans to an unconsolidated CUSO.

Comments: We appreciate the reduction from 250 percent to 150 percent for an investment in an unconsolidated CUSO in the Second Risk-Based Capital proposal. We understand that a CUSO is an unsecured equity investment with no secondary market but the proposal would suggest that an investment is 1.5 times more risky than a loan to a CUSO. If a CUSO was not making money, then the investment and the loan are equally at risk. We have an ownership interest in ten CUSOs, seven of which are managed by others and three of which are managed by ourselves. There was another investment in a CUSO that we had that we wrote off due to obsolescent technology. When a CUSO fails, both the investment and loan are equally at risk, so we believe the loan and investment should have equal weighting.

When a CUSO is managed well, both the investment and loan have no increased risk over and above the activity remaining within the Credit Union. This proposal by itself implies that CUSOs are more risky than those same functions performed within the credit union. The CUSOs we manage are able to pool resources and accumulate funds to be able to hire experts in the field of the business that we would not otherwise be able to hire if each of the credit union owners were each hiring experts. In our circumstances, we hired 1 expert instead of 12 individuals within a confined geographic area for commercial lending, and 1 expert within the commonwealth of PA instead of 60 individuals within the mortgage arena. The Second Risk-Based Capital proposal will reduce the incentive to use the cooperative model to obtain efficiencies to hire experts and operate a company with the best professional expertise. These experts concentrate on the rules and regulations within their discipline and build relationships that we otherwise would not be able to achieve. We view CUSOs as less risky based on the cooperative nature for everyone to succeed and the experts hired to run the operations.

There were a couple of high profile credit union losses partially driven by bad CUSO investments. The reality remains that the overwhelming majority of CUSOs are performing very well, generating considerable savings through economies of scale and providing much needed non-interest income to their credit union owners. The CUSOs we manage have generated positive earnings for many years and have enabled us and 10-15 other credit union owners to save significant costs in hiring experts to run specialized operations.

The proposal groups all CUSOs equally. There are operational CUSOs intended to pool resources to reduce operational costs, similar to the cooperative business model. There are fee generating CUSOs that generate fee income by marketing a product to a credit union's members. There are loan origination CUSOs that underwrite and possibly originate and fund business loans, mortgage loans, credit card loans and other loans. All have separate business plans with different business strategies.

Less than 22 basis points of credit union assets are invested in CUSOs and don't represent a systematic risk that could take down the share insurance fund.

Recommendation: We recommend that the investment in a CUSO and a loan to a CUSO be equally weighted. We further recommend that such weighting be at 75 percent due to the expertise that is brought to the business strategy within the relevant business model that they are operating within and to encourage the use of the cooperative business model.

Mortgage Servicing Assets

Proposal: The Second Risk-Based Capital proposal would set the risk-weight at 250 percent for mortgage servicing assets.

Comment: There was no change in the risk-weight for servicing rights under the Second Risk-Based Capital proposal from the first proposal.

Servicing rights are established when the sale of an asset occurs and servicing is retained, regardless of whether it is a mortgage or not. We also establish servicing rights when we participate commercial loans, automobile loans, etc. We believe that the actual intent of this area is servicing rights in general, not just mortgage servicing rights.

Mortgage servicing rights are traded between financial institutions in an active market. When we sell or participate a loan, we establish mortgage servicing rights equal to our estimation of the present value of future servicing income, subject to a limit of the current active market pricing. And depending on the accounting, a credit union could be subject to accounting adjustments either monthly or annually. If a credit union wants to use mark-to-market accounting, the adjustments would be made monthly, or if a credit union wants to use lower of cost or market accounting, the adjustments, if any, would be made annually when a valuation is performed by a third party. In either scenario, mortgage servicing assets are marked to market at least annually. Therefore, we do not recognize the significant risk in mortgage servicing assets over and above what the market itself is indicating to us and which we must report on the quarterly call report.

In addition, several years ago, 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. The loan participation rule is working and should be allowed to continue working instead of higher risk- weights for mortgage servicing assets.

The other factor that can be considered is whether the sale or participation was performed on a recourse or non-recourse basis and increase the risk-weighting if the loans are sold with recourse and are serviced by the credit union. We agree with the increased risk-weighting in the Second Risk-Based Capital proposal to 100% from 75% for the credit conversion factor.

Recommendation: We recommend a 100 percent risk-weighting for servicing rights on assets sold as such valuation on the financial institution is performed at least annually by experts who value such assets regularly.

Corporate Perpetual Capital (Paid-in)

Proposal: The Second Risk-Based Capital proposal would set a risk-weight for perpetual paid-in corporate capital at 150 percent.

Comments: The Second Risk-Based Capital proposal decreased the risk-weight for perpetual paid-in corporate capital from 200 percent to 150 percent and left the non-perpetual membership corporate capital at 100 percent. The corporate credit unions have had more regulatory changes over the past seven years than any other sector of the credit union system including additional capital requirements, more strict investment limits, concentration risk prohibitions, and governance changes. These previous regulatory changes to the corporate credit union system and the risks they possess have reduced risk to the "system" and should be represented in a lower risk-weight.

The proposed risk-weight does not reflect the actual risk of this asset. The Risk-Based Capital proposal suggests that corporate paid-in capital is twice as risky as a dollar invested in a mortgage loan in excess of 35% of assets. This could serve as a disincentive to credit unions to invest in corporate credit unions.

Recommendation: We recommend paid-in capital should be more appropriately weighted at 125 percent to recognize that the corporate credit union structure is different from what it once was, and now presents less risk to the credit union system. 125 percent also recognizes that the paid-in capital corporate is more risky than safer investments such as treasuries or consumer loans, but less risky than delinquent loans of 150 percent.

Numerator Adjustment-Goodwill

Proposal: The Second Risk-Based Capital proposal would permit goodwill until January 1, 2025 as a component of the risk-based numerator.

Comments: We do not have any goodwill on our balance sheet, but the loss of goodwill within the risk-based capital ratio numerator will present significant problems in the future. For those credit unions thinking of merging in the future, a healthy credit union is less likely to agree to take on a troubled credit union as a partner (even at the request of NCUA). This is going to make it harder and more expensive for NCUA (and the industry as a whole) to find merger partners for troubled or failing credit unions which will ultimately lead to more expensive liquidations for the Share Insurance Fund.

Recommendation: We recommend that goodwill be added back into the numerator of the risk-based capital ratio regardless of any grandfathering provisions.

Numerator Adjustment-NCUSIF Deposit

Proposal: The Second Risk-Based Capital proposal would continue to subtract the NCUSIF deposit as an adjustment to the components of the risk-based numerator.

Comments: The one percent deposit with NCUSIF is unique to the cooperative structure of credit unions and the funding of NCUSIF, unlike the Bank Insurance Fund (BIF). Consistent with the Federal Credit Union Act's mandate that a system of Prompt Corrective Action take into account that credit unions are non-profit cooperatives, inclusion of the one percent deposit is appropriate. In addition, NCUA continues to exclude the one percent deposit noting that it is not an asset available to absorb losses at the credit union, and cannot be double-counted as system equity both for the NCUSIF and a credit union. However, the deposit is available to absorb losses, and although the accounting may be difficult, use of elimination entries when reporting total equity so that NCUA does not double count assets and equity would seem appropriate. For AmHFCU, the one percent deposit is an asset and should not be an adjustment, and we use eliminations entries consistently when we are reporting our consolidated financial statements of the credit union and our subsidiaries.

Recommendation: We recommend that the NCUSIF deposit be added back into the numerator of the risk-based capital ratio.

Numerator Adjustment-Allowance for Loan and Lease Losses

Proposal: The Second Risk-Based Capital proposal would uncap the allowance for loan and lease losses.

Comments: We agree with the change in the cap for the allowance for loan and lease losses from 1.25% of risk assets to 100% of risk assets.

Recommendation: None.

Supplemental Capital

Proposal: The Second Risk-Based Capital proposal does not provide any changes that would allow credit unions the authority to raise supplemental capital.

Comments: Currently, a credit union's net worth ratio is determined solely on the basis of retained earnings as a percentage of total assets. Because retained earnings often cannot keep pace with asset growth, otherwise healthy growth - such as growth resulting from taking deposits or even merging a failing institution into a healthy institution - can dilute a credit union's regulatory capital ratio and trigger non-discretionary supervisory actions under prompt corrective action (PCA) rules. Allowing eligible credit unions access to supplemental capital, in addition to retained earning sources, will help ensure healthy credit unions can achieve manageable asset growth, take advantage of market anomalies and continue to serve their member-owners efficiently.

Supplemental capital authority is needed now more than ever considering the restrictions brought on by this rule. NCUA should call on Congress to pass a legislation solution that modernizes capital standards to allow supplemental capital.

We envision a future where a credit union creates an offering memorandum disclosing its business plans and financial projections for a minimum of five years and solicits investors to provide uninsured capital to allow credit unions to grow more rapidly than under normal circumstances to take advantage of market anomalies, when warranted. Such uninsured capital would then fully amortize over a period of no less than X years to allow a return of such credit union to its natural full member-owned cooperative structure.

Such supplementary capital could also be similar to certificates of indebtedness, which are already authorized. NCUA should reference the use of these instruments to meet risk-based capital requirements. The holder of the certificate of indebtedness would need to perform due diligence on the credit union to evaluate the level of risk in their investment. If an investment was made by an investor after performing their due diligence and agreeing to a rate of return/interest, this level of investigation and subsequent agreement between a willing buyer and seller should provide NCUA with additional comfort that others have evaluated the credit union in the same regard that they have, and that such investment is a prudent business decision, such that that capital infusion that should be included in supplementary capital.

Recommendation: We recommend that supplemental capital authority be incorporated into the Second Risk-Based Capital proposal.

Individual Minimum Capital Requirement

Proposal: The Second Risk-Based Capital proposal eliminated § 703.105 that provided NCUA the ability to require a higher minimum risk-based capital ratio for an individual credit union in any case where NCUA determines that the circumstances, such as the level of risk of a particular investment portfolio, the risk management systems, or other information, indicate that a higher minimum risk-based capital requirement is appropriate.

Comments: We agree with the removal of this section.

Recommendation: None.

Call report preparation

Proposal: The Second Risk-Based Capital proposal recommended changes to the call report without any details.

Comments: As a preparer of the quarterly call report and then as a reviewer, it is difficult to recognize the MBLs and commercial deposits within a credit union. The current call report's loan and share sections are categorized by collateral without incorporating the type of borrower or source. In addition, MBLs are typically on a different computer system than a credit union's consumer loan portfolio. Therefore, mechanical errors can exist as different systems are combined and reported on the call report within one table on page 2. Because consumer loans and MBLs are typically on two different systems, it would be easier to provide the same detail for MBLs as we currently do for consumer loans. It would also be easier for the reader of call reports to understand the amount of business coming from MBLs and consumer products.

Recommendation: We recommend that the loan and share section within the call report be first sorted by consumer and commercial, and then by collateral. Page 2 would look similar to the below with a comparable separation for shares on page 3:

Consumer Loans:

- Unsecured Credit Card Loans
- All Other Secured Loans/Lines of Credit
- STS
- Non-Federally Guaranteed Student Loans
- New Vehicle Loans
- Used Vehicle Loans
- First Mortgage 1-4 Family Real Estate Loans/Lines
- Total Other Real Estate Loans/Lines
- Leases Receivable
- Total All Other Loans/Lines

Commercial Loans:

- Unsecured Credit Card Loans

All Other Secured Loans/Lines of Credit
New Vehicle Loans
Used Vehicle Loans
First Mortgage 1-4 Family Real Estate Loans/Lines
Total Other Real Estate Loans/Lines
Leases Receivable
Total All Other Loans/Lines

By categorizing loans into the detail above, the proper risk weightings can be assigned to commercial loans based on whether the consolidated commercial loans are greater or less than 50 percent, and provide lower risk weights for vehicles and 1-4 Family real estate loans are noted in our other recommendations elsewhere in our comment letter.

Implementation Period

Proposal: The Second Risk-Based Capital proposal has an implementation time period of 4 years after the passage of a final rule and its publication in the Federal Register.

Comments: We appreciate the increase in the proposed implementation timetable to 4 years from 18 months. However, assuming the Second Risk-Based Capital proposal could be published in the Federal Register at the end of 2015, 4 years would make the effective date approximately January 1, 2020. It is our understanding that during 2021 the termination of the corporate stabilization fund is to occur. Such termination may provide credit unions with refunds which would improve net income and ultimately capital. For those credit unions needing additional capital in order to comply with the 10.0% risk-based capital requirement as contained within the Second Risk-Based Capital proposal, it would make sense for such years to coincide.

Recommendation: We recommend that the effective date be extended one more year to 2021 to coincide with the termination of the corporate stabilization fund.

In conclusion, overall we appreciate the changes made in the Second Risk-Based Capital proposal except in the areas of CUSOs and mortgage servicing rights. We stand behind our original comments in these two areas. Overall, however, the Second Risk-Based Capital proposal will allow management to continue to grow our business and serve our members in the fifth largest city and fourth largest metropolitan area in the United States.

I thank you for the opportunity to express our comments and hope you will seriously consider our recommendations prior to rendering the final rule on this complex and extremely important matter for our industry. Our ongoing viability as an industry is in your hands.

Sincerely,

Bruce K. Foulke
President/CEO