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To: regcomments@ncua.gov

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

Re: Comments on Proposed Rule: PCA-Risk-Based Capital (RBC-2)

Dear Mr. Poliquin,

Affinity Federal Credit Union appreciates the second opportunity to provide comments on the National Credit Union Administration ("NCUA") Board's revised proposal (RBC2) to replace the current prompt corrective action ("PCA") rules. While the revised risk-based capital proposal (RBC2) reflects some improvements over RBC1, we continue to have significant concerns with RBC2 as we believe it remains fundamentally flawed.

As has been acknowledged by every financial industry expert, government legislators and regulators, Credit Unions were not part of the problem that led or contributed to the global financial crisis and great recession of the last decade. In fact, credit unions were the bright spot except for the overactive and, as history has proven, unnecessary actions of the NCUA relative to the Corporate Credit Unions. RBC2 is yet another example of this overactive government mindset that is creating a solution in search of a problem that does not exist. We still have serious concerns regarding the proposal's capital adequacy plans, risk-weights, and treatment of goodwill. We also believe the proposed definition of complex credit union does not adequately reflect credit union complexity.

Obligation to Consider the Cooperative Nature of Credit Unions

While we believe a risk based capital system, similar to the BASEL III framework utilized by the global banking community may have some value, we also believe that NCUA has a statutory obligation to protect the cooperative nature of credit unions when creating a risk-based capital regime comparable to FDIC insured banks. The Federal Credit Union (FCU) Act does require NCUA to establish a risk-based capital system that is comparable to that in place for FDIC insured banks, however, the Act also instructs NCUA to take into account the cooperative character of credit unions. In drafting the proposal, the agency appears to have devoted itself to the comparability requirement, while ignoring the cooperative nature of credit unions and we believe the focus should be just the opposite.

Legal Authority

The FCU Act does not provide NCUA the express authority to implement a separate risk-based net worth threshold for the "well capitalized" net worth category. Simply put, Congress has not expressly authorized the Board to adopt a two-tier risk-based net worth standard. The *Federal Credit Union Act* (FCU Act) provides that NCUA shall implement a risk-based net worth requirement that "take[s] account of any material risk against which the net worth ratio required for an insured credit union to be *adequately capitalized* may not provide adequate protection." 12 U.S.C. § 1790d(d). Therefore, we believe NCUA lacks the statutory authority to prescribe a separate risk-based capital threshold for "well capitalized" and "adequately capitalized" credit unions, including the proposed change in the threshold for well capitalized to 10%. We question the need for a higher threshold, particularly when the statutory 7 percent net worth level is well above what is required of community banks under Basel. We are concerned that the additional 300 basis points required to be reserved comes at the expense of having it available for strategic investment and institutional growth. Being able to reach the 10.0 percent target consistently while restricting growth, particularly in a rising rate environment is not conducive to our prudent balance sheet growth strategies.

Supervisory Assessment of Capital Adequacy

We are very concerned about NCUA's proposed additional provisions regarding capital adequacy. NCUA is essentially attempting to define "minimum" capital requirements as opposed to the definition of "well capitalized" set out by Congress in the Credit Union Act. If NCUA is uncertain as to the intent of Congress, it should request clarification, however, if a credit union meets the net worth and risk-based capital requirements to be well-capitalized, the sufficiency of its capital should not be an issue in terms of any rule that could require it to hold additional capital to be considered well-capitalized. Based on a legal opinion sought by industry trade associations, (NAFCU), found that NCUA lacks the statutory authority to impose such requirements.

We believe the proposed plan, which for many credit unions includes a buffer of additional capital to stay above regulatory requirements, should not be the subject of examination and supervision, and the goals a credit union establishes for its own capital sufficiency should not become targets or standards for review in an examination and NCUA should remove this from any proposed or final regulation.

Costly and Unnecessary

Overall, if finalized, the proposal will impose astronomical costs on individual credit unions and the entire credit union industry. NCUA estimates that this proposal will cost credit unions roughly $5.1 million to read the rulemaking and review it against their current policies. NCUA also projects that it will cost $3.75 million for the agency to adjust the Call Report, update its examination systems and train internal staff to implement the proposed requirements. If this proposal were to be finalized, NCUA also estimates credit unions would incur an ongoing $1.1 million expense to complete the adjusted Call Report fields.

In addition, industry analysis estimates that credit unions' capital cushions (a practice encouraged by NCUA's own examiners) will suffer a $490 million hit if NCUA promulgates a separate risk-based capital threshold for well capitalized and adequately capitalized credit unions (a "two-tier" approach). Specifically, in order to satisfy the proposal's "well-capitalized" thresholds, today's credit unions would need to raise an additional $760 million. On the other hand, to satisfy the proposal's "adequately capitalized" thresholds, today's credit unions would need to raise an additional $270 million. Despite NCUA's assertion that only a limited number of credit unions will be impacted, this proposal would force credit unions to hold hundreds of millions of dollars in additional members' equity to achieve the same capital cushion levels that they currently maintain. This proposal would restrict funds that could otherwise be used to make loans to consumers or small businesses and aid in our nation's economic recovery.

Undue regulatory burdens hinder our ability to serve member needs and impede the growth of our credit union system, particularly in the current, fiercely competitive environment. Furthermore, the return on average assets (ROA) shows a clear link between increased regulation and decreased profitability.

This is unreasonable, given how extremely well-capitalized the credit union industry is today. The proposal is an inappropriate use of credit union resources to address concerns about a few credit union outliers. We are seriously concerned by how much money this proposal will cost our institution and the industry as a whole.

Risk Weights

Affinity has been modelling under the Basel standardized as well as Internal Ratings Based (IRB) methodologies for several years. We conduct various stress-scenarios to evaluate and address potential capital-shortfall and improve stability of the Credit Union while operating within a financially-sound risk/reward paradigm. As a cooperative and not-for-profit financial institution, we are chartered to be of service to our membership and are not significant risk takers. While RBC2 makes a number of positive changes to the RBC1 proposed risk weightings, RBC2's risk weights still remain too high in some very important areas and the NCUA should lower these relative to what Federal bank regulators require given our cooperative structure, our proven ability to manage risk and the lower credit union loss history relative to the banks.

The revised proposal increases the risk weight to 100% for non-secured consumer loans and 75% for secured consumer loans, as opposed to 75% for all consumer loans in the original proposal. Affinity offers shorter-term consumer products to meet member needs. These assets are also a tool to help us diversify and manage balance sheet risk. Increasing risk weights on this asset class further hampers our ability to offer products and services in this group, thereby constraining growth.

The concentration penalty for business loans and mortgages, although modified quite significantly, remains an area of concern for us. Affinity has a major interest in the real estate and business lending areas, and as such, the revised concentration-based risk weights will penalize us for these activities and force us to turn away from serving our members. Specifically, current first lien residential mortgage loans over 35% of assets would have a risk weight of 75%, actually higher than the 50%

risk weight for banks. Current and non-junior real estate loans over 20% of assets would also have higher risk weights than provided for banks. The risk associated with these assets are credit related, not concentration, and from an underwriting perspective, a loan originated at 35% concentration is no riskier than the loan originated below 35% concentration. The only possible outcomes for these proposed weightings would be to the detriment of our good members and will put us at a competitive disadvantage and can have an obvious negative impact to the housing market and, ultimately, to the economy. To summarize risk weights, Affinity recommends that NCUA establish a 50% risk weighting level for all current, first lien loans bringing it in line with Community Bank Guidelines; for residential Second Mortgages - Establish a 100% risk weighting level for all current, second lien loans bringing it in line with Community Bank Guidelines.; for Member Business Loans over 50% of assets: Reduce risk weighting from 150% to 100%.

We believe that evaluating concentration risk as part of the exam process, based upon that credit union' risk tolerance and management abilities would be a better way to address this issue. We strongly urge NCUA to make these weights no higher than what is prescribed under BASEL III for Community Banks.

Furthermore, the risk weights for mortgage servicing rights at 250% remain high. These levels are excessive and punitive, impacting our ability to own and operate CUSOs and hold mortgage servicing rights. We request the NCUA to reduce the risk weights for mortgage servicing rights to 150%, incorporate recourse into the equation when determining the risk weight and allow a lower weight of 100% if the loans are sold without recourse but are still serviced.

<u>"Complex" Credit Union</u>

The FCU Act directs NCUA to base its definition of ''complex'' credit unions ''on the portfolios of assets and liabilities of credit unions.'' The proposal, however, would define the term ''complex'' credit union using a single asset size threshold of $100 million as a proxy for a credit union's complexity. We believe that size alone does not dictate complexity and definition of "complex" should actually consider a credit union's portfolios of assets and liabilities, the products and services they offer and the credit unions ability to manage the level of complexity, rather than an arbitrary asset threshold.

<u>Supplemental Capital</u>

Supplemental capital authority is needed now more than ever considering the restrictions brought on by this proposal. NCUA should call on Congress to pass a legislation solution that modernizes capital standards to allow supplemental capital and directs the NCUA Board to design a risk-based capital regime for credit unions that takes into account material risks instead of the current proposed rule. While supplemental capital cannot be included in net worth for most credit unions without a change in federal law, there is nothing in the FCU Act or GAAP that prevents NCUA from including supplemental capital in the numerator of the risk-based capital ratio for RBC, which already includes items that are not part of net worth.

Goodwill

The proposed rule subtracts a number of components from the numerator portion of the RBC ratio, which includes goodwill. We believe this would act as a disincentive in merger activity, thereby preventing healthy industry consolidation and the combining of unhealthy credit unions with stronger ones in the future.

Interest Rate Risk

The agency has indicated that it is currently considering an alternative approach to taking account of IRR. NCUA should continue to apply industry-accepted methods as part of a competent supervision and examination process. NCUA already has a number of requirements and guidance regarding interest rate risk that credit unions must comply with, such as the interest-rate risk final rule, a letter to credit unions on the subject (12-CU-05), and it is the top subject in the most recent NCUA supervisory focus (14-CU-01).

History has shown that credit union exposure to IRR is modest and credit unions have a record of superlative IRR management. NCUA confirmed at the Alexandria Listening session held on July 17, 2014 that there has never been a credit union failure associated with IRR. Credit Unions continually demonstrate their ability to manage, monitor and control such risk and should not be subject to layers of new IRR regulation.

Banking regulators account for IRR through their annual examination process by ensuring that banks maintain sufficient capital for interest rate risk. NCUA's existing supervisory and examination mechanisms provide it the same authority to ensure that credit unions have enough capital to absorb the level of IRR on their balance sheets. If NCUA were to promulgate a rulemaking on IRR, the agency would hold credit unions to significantly different standard than banks.

Conclusion

We believe that excessive regulation often drifts away from its original target and entails costs that exceed their benefits, with a negative impact on productivity, innovation, capital investments and progress, which could affect our growth, both at the institutional and Credit Union industry levels. Affinity Federal Credit Union was chartered in 1935 and today, we are the largest credit union headquartered in New Jersey. As a member-owned, not-for-profit, full-service financial institution we are proud to serve more than 135,000 members and look forward to sustained and prudent growth in the future. We encourage NCUA to avoid unnecessary, excessive regulation by removing the RBC2 proposal and to continue to make substantial improvements through collaboration with the industry and the financial community at large. Together we can evolve a sustainable, growing, safe and sound system to serve members, consumers and businesses long into the future.

We thank you for your consideration in reviewing our comments. Strategic capital planning is very important for us and as such, long-term capital ratio targets are based on our assessment of potential risks and tolerance levels for risks set forth by our Board of Directors. The issues we have highlighted above have a significant impact on our institution and our ability to serve our members. We respectfully urge NCUA to address some of the recommended improvements to the proposal contained herein.

If we can be of further assistance in providing further information on this comment letter, please do not hesitate to contact us.

Sincerely,

John T. Fenton
President and Chief Executive Officer
Affinity Federal Credit Union, Charter #857
Basking Ridge, New Jersey

cc Members of Congress