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

April 24, 2015

Dear Mr. Poliquin:

Re: Comments on Proposed Rule: PCA - Risk-Based Capital; RIN 3133-AD77

Thank you for the opportunity to comment on the revised proposed rule regarding risk-based capital. We have familiarized ourselves with the provisions of the rule and its implications to Alaska USA Federal Credit Union (Alaska USA), as well as the credit union community in general. We believe that despite noted changes from the original 2014 proposed rule, the revised rule continues to contain provisions that may result in adverse unintended consequences. Accordingly, we have concluded that the revised proposed rule would not be in the best interest of credit unions, credit union members and the share insurance fund.

More specifically, the proposed rule does not adequately reflect the unique nature of credit unions, vis-à-vis banks, and will place credit unions at a distinct competitive disadvantage. For all "complex" credit unions, in the absence of material changes in activities and/or the structure of its balance sheet, the revised rule will require additional retained earnings in order to maintain a credit union's relative capital position in terms of the buffer needed to avoid regulatory intervention. Since credit unions do not have access to supplemental capital, the balance sheet adjustments encouraged by the proposed rule will impact the competitive position and long-term growth of credit unions as they withdraw from, or curtail, profitable activities judged by the NCUA to harbor more risk, and/or adjust pricing to ensure capital requirement compliance. This becomes particularly problematic when the risk-based capital requirements exceed those of competing community banks, which have the ability to raise additional capital.

We believe that the broad-brush approach characteristic of the revised rule ignores important differences among credit unions, their membership, and the markets in which they operate. Examples of this point applicable to Alaska USA are described below. In addition, by establishing significant risk-weight differentials among asset classes and/or to characteristics within asset classes, credit unions will have a strong motivation to evolve their activities and balance sheets to maximize their potential under the risk-based capital provisions. This will happen regardless of their particular situation and whether the incented behaviors are in their best long-term financial and strategic interests and the service interests of their members. Accordingly, the proposed rule continues to represent a de facto assumption on important balance sheet management decisions by the NCUA for purposes of protecting the share insurance fund at the expense of the current prerogatives and interests of individual credit unions and their members. Further, since the implicit incentives are the same for every credit union, over the long term the proposed risk-based capital requirements will cause credit unions to become less financially diverse, which will increase the vulnerability of the industry and the share insurance fund to widespread economic adversities. These are the unintended consequences of the revised proposal that must be avoided.

One last general point, we fail to see the need to change the current capital rules. The current system, coupled with regulatory risk-management requirements, successfully coped with the most severe economic calamity since the Great Depression. Further, regulatory risk-management requirements have been enhanced over the last several years. Consequently, we believe that deficiencies in the proposed rule

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as described below and the real potential to increase the risk to the share insurance fund make this proposal unnecessary and unacceptable. Nevertheless, if the proposed rule goes forward, please consider our comments and recommendations presented below.

Goodwill:

Beginning in January 1, 2025, the proposed rule would require outstanding goodwill recorded from supervisory mergers or mergers completed prior to the publication of the final rule, be deducted from a credit union's net worth in determining risk-based capital. Any goodwill recorded after the publication of the final rule would be deducted from a credit union's net worth in determining risk-based capital. This would serve as a major disincentive to acquiring any entity with insufficient tangible assets to justify its asking price, such as a weak or failing credit union. Accordingly, this provision may have significant unintended consequences to the share insurance fund when the NCUA is trying to find a merger partner for a troubled credit union. In addition, the value of many businesses, such as insurance agencies and mortgage companies, is based on intangibles that are properly accounted for under GAAP. Deduction of goodwill in determining risk-based capital could materially affect the acquisition pricing decisions, to the detriment of the share insurance fund. Accordingly, we recommend that goodwill not be deducted from net worth in determining risk-based capital.

Mortgage Servicing Assets:

The proposed risk weight for mortgage servicing rights (MSRs) is 250%. Alaska USA holds nearly $5 billion in MSRs, and we fully understand and are sensitive to the risks associated with MSRs. We believe that a flat 250% does not accurately address the potentially wide variations of risk that could exist under differing circumstances. In many situations the 250% would be punitively excessive and is inconsistent with the weights assigned to portfolio mortgages that represent greater overall risk.

More specifically, since much of the risk associated with holding MSRs relates to the volatility of their market value with changes in interest rates, credit unions that book MSRs at, or close to, their current market value are at a greater risk of loss in a falling interest rate scenario. Those institutions that book MSRs more conservatively have a built-in book to market value cushion to absorb normal downward fluctuations in market value and are in a better position to recapture their investment over a shorter period of time. In a rising rate environment the value of MSRs and the corresponding cushion grow and the risk declines. Consequently, a flat 250% in all circumstances would be punitively excessive for those credit unions that conservatively book MSRs, particularly in a low interest rate or low refinance environments. The 250% risk weight discourages the retention of MSRs, potentially to the financial detriment of the credit union and service interest of the members. It also discourages the sale of originated mortgages into the secondary market to generate liquidity for additional lending purposes and to otherwise reduce risks implicit in holding mortgage related assets.

It is important to note that the operational risks associated with MSRs are not avoided by holding originated mortgage loans in portfolio, yet the risk weights of portfolio mortgage loans varies from 50% to 75%, despite the fact that such assets are burdened with a multitude of other risks not inherent in MSRs.

Case in point, for a variety of sound asset/liability and liquidity management purposes, Alaska USA sells nearly all of the mortgage loan production into the secondary market and retains a sizable portion of the servicing rights for member service and risk mitigation purposes, the latter in terms of the stability of earnings from the aggregate of mortgage-related activities over time. The MSRs are booked at the low end of their current market value. Alaska USA's MSR portfolio market value is evaluated independently each quarter, with the market value consistently representing more than the stated book value, representing a sizable off-balance sheet asset. Nevertheless, the proposed rule would impose an unrealistically high risk-based capital burden. Accordingly, we recommend that the risk weight for MSRs be based on a reasonable formula related to the ratio of book value to market value and in any case not exceed 75% risk weighting.

Non-Delinquent Mortgage Loans:

The revised proposed rule requires risk weightings for first lien mortgage loans in portfolio that vary from 50% to 75%, depending on the extent of these mortgage assets within the portfolio, and from 100% to 150% for junior lien mortgage loans in portfolio, again depending on the extent of those mortgage assets in portfolio. In contrast, the comparable risk weights for community banks are a flat 50% and 100% respectively, for first and junior lien mortgage loans. Although we understand the reasoning associated with the proposed risk weight differences between first and junior lien mortgage loans, this provision ignores particular circumstances of individual credit unions. For example, a credit union with a highly mobile field of membership and a mortgage loan portfolio with a short average life might be discouraged from booking mortgage loans because the punitive capital requirements that escalate as concentrations in each mortgage category increase. In light of the significant competitive disadvantage for all credit unions, and to ensure individual credit unions are not penalized for booking higher percentages of mortgages, we recommend that the respective 75% and 150% risk weighting escalations for first lien and junior lien mortgages respectively, be dropped in favor of flat 50% and 100% risk weightings, which is equal to those of the community banks.

Non-Current Junior Lien Real Estate Loans:

The proposed rule calls for a risk weighting for non-current junior lien real estate loans of 150%. In contrast, the comparable risk weight for community banks is 100%. This significant risk weighting could result in many credit unions becoming less flexible in working with members that have fallen behind on their payments. Comparatively, community banks would be more inclined to work with their customers as there is no change in how these particular loans are risk weighted against their capital. In light of this potential to negatively impact credit union members, we recommend that non-current junior lien real estate loans be weighted 100%, equal to that of community banks.

Share Secured and Compensating Balances Loans:

The proposed rule calls for a risk weighting of 20% for share-secured loan balances and member business (commercial) loans secured by compensating balances. In contrast, the comparable risk weight for community banks is 0% if the cash is on deposit in the bank, which is appropriate given there is no risk. Accordingly, we recommend that loan balances secured by shares or compensating balances on deposit at the originating credit union be reduced to a 0% weighting, and loan balances secured by compensating balances on deposit at another financial institution be weighted at the proposed 20%.

Subordinate Tranche of any Investment:

This section of the proposed rule provides a default assignment weighting of 1,250%, or the use of the Gross-up Approach to determine the overall weighting of this category of investment. Although we agree with the elimination of the subjective nature of the original proposal's "credit union demonstrated comprehensive understanding" provision, the continued inclusion of the 1,250% risk weighting is obviously punitive in nature and cannot be justified from a safety and soundness standpoint as it represents more than 100% of the monies at risk in any one investment. Additionally, the specific exclusion of the Simplified Supervisory Formula Approach eliminates a measurement tool allowed by other U.S. banking regulators and the Basel Committee on Banking Supervision. This could represent a competitive disadvantage to credit unions who are evaluating this investment class for inclusion in their strategies. Given the significance of the weighting and the exclusion of the evaluation method, we recommend that the 1,250% weighting be eliminated and the Simplified Supervisory Formula Approach be utilized to determine the weighting of investment categories.

Non-Agency ABS Structured Securities:

This section of the proposed rule calls for a 100% risk weighting for all non-agency ABS structured securities. However, collateral utilized to secure investments included in this category could include automobile loans. The proposed rule also requires a risk weighing of 75% for all current secured consumer loans. As the risk profile of the underlying collateral does not differ between secured automobile loans and non-agency ABS structured securities backed by secured auto loans, we recommend that the risk weighting for both instruments be set at 75%.

Unfunded Loan Commitments:

This section of the proposed rule identifies the use of a 10% credit conversion factor for all non-commercial unused lines of credit. In contrast, community banks utilize various credit conversion factors ranging from 0% to 50% depending on if the commitment is unconditionally cancellable (0%), conditionally cancellable within one year (20%), or conditionally cancellable beyond one year (50%). The design and inclusion of cancellation language in lending contracts is to mitigate the overall potential risk associated with unfunded amounts. The type and extent of the specific language helps outline the extent and timeframe of the risk associated within each lending contract. As such, we recommend that the credit conversion factors utilized by the community banks be adopted by the NCUA. This will help ensure that the inherent risk embedded within specific cancellation language in lending contracts be accurately identified and risk weighted.

Implementation Period:

The proposed rule identifies an implementation date of January 1, 2019, which is approximately four years from the date the revised proposed rule was introduced for comment. Although longer than the originally proposed 18-month implementation, this timeframe remains insufficient given the significance of the impact of the proposed requirements and the length of time it will take credit unions to adjust their business strategies, portfolios and capital to best position themselves relative to the rule. This task is burdensome for credit unions, given their limited options for raising capital compared to banks, which have been afforded a full seven years to fully implement BASEL III. Accordingly, we recommend an implementation period of at least seven years.

Summary:

For an organization that can only earn its capital, externally imposed requirements for reserves in excess of prudent levels required within the context of the organization's particular circumstances presents a material threat to the organization, in and of itself. For the reasons presented above, we view the NCUA's proposed rule to address concerns regarding risk to the share insurance fund as a material threat to member service, to credit unions' competitive posture and to the long-term health and prosperity of the credit union community and the share insurance fund. We therefore recommend that the revised proposed rule be abandoned. Otherwise, we strongly recommend that the risk weights and resulting reserve requirements be modified as recommended in this letter.

Thank you for considering our comments and position on this matter.

Sincerely,

William B. Eckhardt
President