April 7, 2015

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

Service 1st Federal Credit Union
Charter: 22128

Dear Mr. Poliquin:

On behalf of Service 1st Federal Credit Union, we provide the following comment letter for the record regarding the National Credit Union Administration (NCUA) proposed risk based capital rule issued January 15, 2015. We appreciate the opportunity to provide our thoughts on this important regulatory proposal, to express some of our concerns about the potential negative impact of the proposed rule on credit unions if finalized in its current form and to offer some suggested improvements in the rule for your consideration as you move forward in the rulemaking process. We also express our appreciation to NCUA for considering the over 2100 comment letters during the initial proposals comment period, one of which was ours.

After again reviewing the Federal Credit Union Act, we question the legal right of the NCUA to establish the proposed risk based capital rule. We believe the Federal Credit Union Act permits one standard or criteria for a complex credit union and that is to be adequately capitalized. The risk-based capital requirement for a complex credit union to be well capitalized is contrary to the Federal Credit Union Act. Therefore, the proposed well capitalized standard for a complex credit union exceeds NCUA's authority in terms of implementing a mechanism for risk based capital and should be removed from the proposal. In summary, we believe Congress has not authorized NCUA to adopt a two-tier risk based net worth standard.

However, if the NCUA moves forward with this risk based capital rule, supplementing the existing one-size-fits-all net worth regime with a new one-size-fits-all set of risk-based capital standards does not make sense. Any capital or net worth system that does not accommodate the difference in asset risk-based upon the historical performance of our credit union in effectively managing that risk is flawed and doomed to restrain the very growth in reserves it is designed to foster through increased earnings. The paragraphs below outline our concerns of the NCUA's proposed risk based capital rule:

Definition of a Complex Credit Union

The NCUA raised the definition of a complex credit union from $50 million to $100 million. We do not believe that a credit union should be considered complex based merely on asset size. The complexity of a credit union's balance sheet is determined by factors such as share and loan types, investments, member services, and overall portfolio composition. This approach would be more consistent with the Federal Credit Union Act which requires the NCUA to consider the portfolio of assets and liabilities of credit unions when determining whether they are complex.

Consumer Loan Component

The NCUA decided after the first round of comments to change the 75% risk-weight for both current consumers secured and unsecured to 75% for current consumer secured and 100% for current consumer unsecured. With the historical performance of credit unions in managing consumer loan risk, a 50% weight for secured and a 75% weight for unsecured makes more sense. If the risk-weights stay at their current levels, our credit union will have to determine whether certain consumer loans make sense from a business standpoint, which in turn, will reduce the services we are able to provide to members. Consumer loans are the bread and butter of our credit union, and the thought of having to reduce products available to members is saddening.

Member Business Loan (MBL) Component

The NCUA has decided to keep a concentration penalty for business loans at 50% of assets. We feel as though these risk-weighting percentages are arbitrary and there is insufficient data to make an informed rule. How does the NCUA justify that a loan above 50% of assets deserves a risk-weighting of 150% while a loan under 50% of assets is risk-weighted at 100%? Concentration risk is a case-by-case issue that is best evaluated by the examiner at each credit union rather than in a one-size-fits-all regulation applicable to all credit unions that make business loans. Our historical loss performance in this portfolio is less than half of what we've experienced in our indirect automobile, credit card, and unsecured portfolios. This rule does not take into account underwriting standards or collateral. An MBL that is fully secured should not be considered as risky as an unsecured MBL. We feel the NCUA needs to reconsider and rethink the proposed changes to MBLs.

Real Estate Loan Component

The NCUA has decided to keep concentration penalties for first and junior lien real estate loans at 35% of assets and 20% of assets respectively. As stated above, this takes an arbitrary number and applies a penalty for exceeding that. During the course of the last three years, our credit union has experienced net charge-offs of $143K in this category. The simple average of our real estate portfolio during that time is $113M. This equates to a loss of 0.126% during that time period. A credit union like ours, with strict underwriting criteria, extremely knowledgeable lending staff, and a portfolio that has performed extremely well, does not feel like this proposal does anything to benefit us. This could potentially be another area where we have to decide whether certain products make sense to offer to our membership. In the end, the members are the ones who will lose.

Loans to Credit Union Service Organizations (CUSO) and CUSO Investments

The NCUA has decided to apply a 100% risk-weight percentage to Loans to CUSO's and reduce the 250% risk-weight percentage to Investments in CUSO's to 150%. This arbitrary risk-weight assignment is counterintuitive to the credit union philosophy of working together. These successful investments will potentially penalize us in the future, even though the track record of these organizations is positive. Being able to collaborate with other credit union's via CUSO's allows credit unions to offer products and services to members that they would otherwise not be able to offer due to lack of resources and high startup costs. The NCUA has admitted a lack of data on CUSO's, so how does it justify the proposed risk-weight percentages?

Interest Rate Risk (IRR)

While we commend the NCUA for removing the IRR component from risk based capital, it appears that future regulation on IRR is in the works. IRR regulation will no doubt have an impact on risk based capital and will likely restrict credit union's earning potential. Had our credit union loaded up on 10 year investments in 2008, we would've likely been scrutinized heavily and might have been forced to sell a portion of these investments. However, seven (7) years later, rates have not risen. The potential earnings left on the table due to fear of regulatory scrutiny are significant. While IRR and risk based capital can't feasibly be incorporated into one regulation, we would like the NCUA to realize that any future IRR regulation may have a serious impact to credit unions.

Our fear is that these rules, as proposed, will have the unintended consequences of restricting credit union growth, assisting members with products and services they want and need, and ultimately, resulting in less capital growth. Please allow us to run our credit union as we see fit as we have a proven track record of success without taking risk. Don't allow a few risky credit union failures change the course of the entire credit union movement. Thank you for the opportunity to comment on this proposed regulation. While we do believe the current proposal is certainly more balanced than the original, we still feel the new proposal needs much refinement to be perfected and we encourage NCUA to consider some of the recommended improvements contained in this letter.

Respectfully,

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