April 16, 2014

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke St
Alexandria VA 22314

RE: Prompt Corrective Action - Risk-Based Capital; RIN 3133-AD77

Dear Mr. Poliquin:

I am writing today regarding the NCUA's proposed rule to establish risk-based capital requirements. MN Catholic Credit Union agrees that there is a need to adjust the existing capital system, and that the proposed rule has many valid ideas in it. However, there are a number of areas in the proposed rule that are concerning and we feel are unwarranted.

In the past credit unions have held various assets on their books and, in certain situations; they have exhibited more risk than expected. But as a group, credit unions came through the latest recession in very good condition. Using each instance where an asset class showed signs of stress as a template for this rule does not take into account why those problems existed nor if other steps have already address the issue. It appears that the rule was put together with emotion and not analysis. We want transparency into how the rule was compiled.

MCCU appreciates NCUA's intention to help credit unions and thus reduce risk to NCUSIF. However, we cannot support the proposed rule in its current form, and, although well-intended, find it carries significant, unintended consequences. We have a number of concerns regarding the proposed rule, including:

1. The lack of empirical foundation for the assigned risk-weights, and in particular justification for inclusion of concentration escalators;
2. The conflicts in the current proposed risk-weight categories, as well as the over-generalized asset categories;
3. NCUA's ability to subjectively impose additional capital requirements on a case-by-case basis;
4. The failure to include in the numerator certain "credits" to assist in balancing a credit union's overall portfolio, deductions of the NCUSIF deposit and general lack of consideration of mitigating factors, and;
5. Inadequate implementation time for credit unions to come into compliance, including sufficient opportunity for credit unions to make strategic plan adjustments.

1. Lack of empirical data and analysis for risk-weights

It would be helpful for NCUA to provide an evidence-based RBC proposal that incorporates the underlying analysis, including any historical data used, on how types of risk-weight categories were assigned. While NCUA may have undertaken significant analysis and research to determine the various risk-weight categories, such analysis has not been provided as part of the proposed rule. Credit unions would be better served if NCUA would provide the basis for assigning certain risk-weight categories in order to engage in a healthy debate as opposed to creating confusion, misunderstanding and skepticism regarding the motives for risk-weighting certain categories. Currently the proposed rule is open to speculation, and appears to be based on NCUA's reaction to things that have happened in the past rather than focusing on improving the industry for the future.

Specifically, I would like to know what the justification is for portioning out MBLs, consumer mortgage loans, and CUSOs, as particularly high-risk lending and investment areas.

2. Conflicts in risk-weight categories and over-generalized asset categories

I have a number of concerns regarding the proposed risk-weights and find them to be confusing, unbalanced, and in some instances, onerous. While NCUA has indicated its intention to bring credit unions more in line with Basel III, by attempting to address multiple risks simultaneously – liquidity risk, concentration risk, interest rate risk, as well as credit risk – it creates conflict within the system because many of the resulting categories are inconsistent.

For example, it makes no sense to assign the same risk category to a vehicle loan, as an unsecured signature loan. Our historical loss ratios are much higher on signature loans than on vehicle loans. The current proposal appears to fail to assign risk-weight categories based on the historical market experience of the industry.

- Fully insured assets risk-weighting

It should be clarified that any money held overnight in the Federal Reserve Bank should specifically be categorized as a zero percent risk-weight, instead of its current generalized treatment with cash on deposit and receiving a twenty percent risk weight. Further, any deposits or mortgages (FHA/VA) which are fully insured should also be removed from the twenty percent risk-weight, and re-allocated to a zero percent risk weight. Basel III treats government sponsored entity (GSE) loans as zero risk-weight. While the proposed rule reflects that a twenty percent rate is assigned because of potential interest rate risk, assigning any risk-weight to account for other types of risk is moot for fully insured real estate loans since any claim would pay the loan in full.

- Credit union service organization risk-weighting

The unilateral risk-weight for investments in CUSOs in the two hundred fifty percent (250%) category does not make sense to me. When determining the appropriate risk-weight for a

CUSO, consideration for the underlying purpose, type of CUSO and health of the CUSO should be considered. Just as with Credit Union, some CUSOs are stronger than others, so to paint them all with the same brush does not make sense.

- <u>Member business loan risk-weighting</u>

NCUA should provide the data to support this risk weighting. It appears that the NCUA is reacting to the past instead of analyzing the true risk. I recommend the NCUA rethink the unintended consequences of arbitrarily restricting MBLs.

3. <u>Imposition of additional capital requirements on case-by-case basis</u>

MCCU is opposed to the proposed rule's allowance for imposing additional capital requirements on a case-by-case basis. This provision is not only unpredictable, but provides for unfettered and arbitrary capital requirements to be imposed. This provision should not be necessary if the proposed rule is configured properly. MCCU recommends the NCUA delete this part of the proposed rule.

4. <u>Lack of "credits" in the numerator for the RBC ratio</u>

NCUA should look at all aspects of the balance sheet, and focus as well on the numerator of the risk-based net worth ratio, and not just the asset side as reflected in the denominator. The risk-weights should work both ways, whereby credit unions have the ability to hedge interest rate risk by obtaining "credit" in other low-weight assets, such as certificates of deposit.

In the numerator side why has the NCUSIF deposit been removed? We believe it should be re-introduced as an intangible asset taken into account as part of the numerator. We are required to maintain the deposit and in part it helps cover risk.

Another area of concern is that the Allowance for Loan Losses is limited to 1.25% of risk assets. Why limit or restrict it at all? We have not seen any persuasive information provided by NCUA to support this treatment. NCUA restricts us from over funding it, and the motivation for the RBC system is to maintain a proper capital allowance for the risk of losses, so the reasoning for limiting the ALLL is unclear. While the commentary in the proposed rule reflects that the ALLL limit is consistent with the Basel III, that does not justify its application to the overall risk-based capital rule, particularly in light of credit unions' historically low loss rates compared to small banks.

5. <u>Proposed 18 month implementation period</u>

The proposed implementation period of eighteen months is insufficient. Banks have had almost nine years to plan for various portions of the Basel III system, and while this will not affect MCCU directly, we feel it is both inconsistent and puts credit unions at an unfair disadvantage. MCCU urges NCUA to reconsider the proposed eighteen month implementation period in favor of a much longer period to allow our credit unions sufficient opportunity to make strategic decisions, instead of forcing quick decision-making for short term solutions.

<u>In conclusion</u>

Even though the RBC proposed rule may not directly affect credit unions under the $50 million threshold like MCCU, another unintended consequence of RBC is the prevention of mergers and the ripple effect caused in the industry. If a well-situated credit union relies on its goodwill to take over a troubled credit union, and is no longer able to take such a risk under RBC's implementation because of a lack of allowance for goodwill, NCUA is then forced to step-in which subsequently negatively impacts the NCUSIF, and further results in payment of additional premiums by all credit unions.

The credit union mission is to serve its members, and it is becoming increasingly more onerous for credit unions to provide readily available consumer lending products, particularly mortgage loans. While one aspect of NCUA's purpose is to protect the NCUSIF fund and limit risk, part of NCUA's mission also includes supporting the credit union movement and industry. Overall, the current risk-based capital proposed rule goes too far – in NCUA's zealousness to curb industry risk, the resulting proposal is a punitive system instead of providing credit unions with opportunities for healthy growth and success.

It is our belief that the NCUA has put this proposed rule together as a reaction to the events that stemmed from the Great Recession, without applying rational thought and calculation. MCCU agrees that changes should be made to better identify those credit unions which possess more risk and better protect the NCUSIF into the future, but this rule – in its current state – is not the way to do it.

Sincerely,

David C Sawin
CEO
MN Catholic Credit Union