THE POWER OF ME. MEMBERS COOPERATIVE CREDIT UNION
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May 13, 2014

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

VIA ELECTRONIC DELIVERY: regcomments@ncua.gov

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

Dear Mr. Poliquin:

On behalf of Members Cooperative Credit Union (MCCU), please accept this response as input to the proposed rule to establish risk-based capital (RBC) requirements for federally-insured credit unions. MCCU is a $400 million credit union serving over 30,000 members in a seven-county geographical field of membership in northern Minnesota.

We appreciate the opportunity to comment on this proposal, which could have significant impact on our members and the credit union system. While MCCU generally supports a risk-based capital system that reflects methods currently used in the financial industry, we believe the NCUA's proposal is not the best approach for our members specifically, nor the credit union industry in general.

We have a number of concerns regarding the proposed rule, including:

1. The attempt by the proposed rule to address too many risk factors in a single rule;

2. The conflicts that exist in the proposed risk-weight categories, as well as the over-generalized asset categories;

3. Deductions from both the numerator and denominator related to NCUSIF deposits and goodwill.

4. Lack of consideration for a credit union's existing capital buffer;

5. Individual minimum capital ratios;

6. The overall implication that certain areas of a credit union's portfolio, such as consumer mortgages, member business loans (MBLs), and Credit Union Service Organizations (CUSOs), should be restricted areas of growth.

The attempt by the proposed rule to address too many risk factors in a single rule

Risk-based capital rules implemented by BASEL III and other comparable federal banking agencies focus on credit risk. The proposed rule goes well beyond this, and also attempts to address interest rate risk, concentration risk, and liquidity risk. These risk factors all have significant fundamental differences as to their cause and effect, and therefore merit their own risk management and mitigation strategies and provisions. To address all risks in a single algorithm is simplistic, and does not take into consideration the underlying causes of these risks, and may lead to unintended consequences.

For example, the proposed rule attempts to reduce interest rate risk while only considering the asset side of the balance sheet. Depending on the mix of the credit union's balance sheet, the rule, through asset weighting, could entice credit unions to reduce the duration of their assets and actually increase interest rate risk. MCCU has a substantial amount of stable core deposits, and we have been using long-term share certificates to manage our interest rate risk. These mitigation strategies are not considered in the RBC ratio calculation.

The reality of an actively managed balance sheet makes the mix of assets and liabilities in the balance sheet dynamic. The proposed rule may actually inhibit the management of interest rate risk on our balance sheet as we change our balance sheet structure to meet RBC requirements at the expense of more effective interest rate mitigation strategies that consider both the asset and liability side of the balance sheet.

Conflicts in risk-weight categories (702.104(c))

The risk-weights for different asset categories do not appear to reflect the underlying risk of each asset class, leading us to question the empirical support for the risk-weights. Our experience shows that consumer vehicle loans do not bear the same risk as unsecured signature loans. Yet, the proposed rule assigns the same weight to each category of loan. The proposed rule fails to assign risk-weights based on the historical market experience of the industry.

Mortgage loans are another area where the proposed rule assigns risk-weights that are inconsistent with industry experience. There is inherently different risk between fixed rate, adjustable rate, variable rate, and other types of mortgage loans. Further, there is a complete absence of consideration for loan to value ratios. To truly represent the market risk, these categories should be broken out and risk-weighted separately, instead of being grouped together and risk-weighted based on concentration alone. There are mitigating factors that are taken into account as part of the underwriting process, and NCUA should consider other factors when assigning risk-weights.

Fully insured assets, such as deposits held overnight in the Federal Reserve Bank, should receive a zero percent risk-weight, instead of the proposed risk-weight. Why would credit unions need capital to cover deposits held at the Federal Reserve Bank? The implication is that the proposed risk-weight is intended to cover any interest rate risk associated with these deposits. However, since they are liquid and fully insured, we could quickly react in a changing rate environment to mitigate any interest rate risk associated with these deposits.

The overall risk-weight for investments and loans in CUSOs of 250% is excessive and may lead to unintended consequences. Many CUSOs are well established and have served the credit union industry by reducing credit union expenses, making the member credit unions stronger and better able to compete, and providing significant benefits to the communities credit unions serve. Many CUSOs provide services that are too costly for natural person credit unions to staff and perform internally, thus resulting in significant cost savings. The proposed risk-weighting of 250% will cause credit unions, especially those on the cusp of being considered "well capitalized," to reconsider investing in a CUSO, even if such an investment could result in significant cost savings. When determining the appropriate risk-weighting for a CUSO, the underlying purpose and type of CUSO should be considered.

Delinquent loans receive a risk-weighting of 150% under the proposed rule, presumably to cover the credit risk associated with these loans. Since our ALLL is fully funded in accordance with GAAP to cover any credit risk associated with these loans, why are we also required to maintain an additional 15.8% of delinquent loans in our capital? The risk-weighting for delinquent loans is excessive. As a credit union serving predominately low-income members, our reportable delinquency may be higher than other credit unions that that do not. The seemingly arbitrary risk-weighting on delinquent loans will impact how we are able to serve our low-income members.

Deductions related to NCUSIF, Goodwill, Intangible Assets and Allowance for Loan and Lease Losses (ALLL)

The proposed rule deducts the NCUSIF deposit, goodwill and other intangible assets from both the numerator and denominator in calculating the RBC ratio. The implication is that these assets would receive no value and would actually reduce net worth in liquidation. If this is the reason the rule deducts these assets from both the numerator and denominator, then consideration should be given to the liability side of the balance sheet as well. There are many liabilities that will not be paid at the stated value in liquidation. These liabilities should be added to the numerator in calculating the RBC ratio.

However, we question the validity of this reasoning. The NCUSIF deposit is an important asset, especially in the event of liquidation. As an important asset, it should be included in the denominator at a zero risk-weighting, and not be deducted from the numerator. The resulting RBC ratio more accurately reflects the capital available to protect credit union members.

Excluding goodwill and intangible assets from the calculation of both the numerator and denominator arbitrarily reduces the calculated RBC ratio. The NCUA excludes these assets from the calculation because they are not tangible assets. However, GAAP requires these assets to be assessed for impairment each year. We urge NCUA to reconsider the treatment of these assets in the proposed rule. The rule not only ignores a valuable asset in arriving at the RBC ratio, it will also make mergers between credit unions less attractive.

Another area of concern is how the proposed rule limits the ALLL to 1.25% of risk assets. As a contra-asset dedicated to cover credit risk on our balance sheet, why limit this in the calculation of the denominator? The NCUA reasons that limiting the ALLL in the calculation of the numerator to 1.25% of risk assets will encourage credit unions to make less risky loans. This proposed limit, when combined with the risk-weighting on delinquent loans, serves as a double penalty on credit union lending. On the one hand, we are not given full credit in the proposed RBC ratio numerator for our ALLL, and we are also asked to include 150% of delinquent loans in the calculation of the denominator. There are other, more effective and less arbitrary ways to encourage credit unions to follow sound lending practices, if that is NCUA's concern.

Furthermore, to limit the ALLL to 1.25% of risk assets does not take into account the diversity among credit unions. Credit unions with lower loan-to-share ratios may be able to make "risky" loans while fully funding their ALLL and still falling below the 1.25% limit. Meanwhile, credit unions with higher loan-to-share ratios, and that do not make "risky" loans, may find that their ALLL exceeds the 1.25% limit established by the proposed rule, and run the risk of being considered under-capitalized. As currently proposed, the rule may not even accomplish its intended purpose.

Lack of consideration for a credit union's existing capital buffer

A major focus of our credit union is our capital level. We have strategically planned and maintained a buffer above the well capitalized level threshold. It has taken us years to reach this goal. The implementation of this proposed rule as it currently reads will significantly reduce the capital buffer we have so carefully built. The unintended consequence of this proposed rule is that we, along with many other credit unions who have worked so hard to create a capital buffer, will revise our strategic goals more conservatively. This will hamper credit union growth; restrict the products and services provided to members; and make credit unions less competitive.

Individual minimum capital ratios

The proposed rule includes a provision that NCUA may require a higher minimum risk-based capital ratio for an individual credit union in any case where the circumstances, such as the level of risk of a particular investment portfolio, the risk management system, or other information, indicate that a higher minimum risk-based capital requirement is appropriate. For example, higher capital may be appropriate for a credit union that has significant exposure to declines in economic value of its capital due to changes in interest rates.

We have significant concerns about having a subjective approach to required capital levels and NCUA's ability to determine higher minimum risk-based capital at its own discretion in a fair and consistent manner.

Overall implication that Mortgages, MBLs, and CUSOs should be restricted areas of growth

Our overall concern is that the proposed rule penalizes certain assets without regard for how credit unions have mitigated the risk associated with these assets through balance sheet structuring. Serving the needs of our members, and the communities in which they live, is our primary concern. We need to be able to make MBLs to credit-worthy business operators in order to create new jobs in our communities. We need to be able to help our members achieve their dreams of owning a house. We need to be able to invest in CUSOs that allow us an opportunity to provide new or enhanced services to our members that we cannot provide internally or as cheaply. The proposed rule, as currently written, would inhibit our ability to do so. The proposed rule penalizes us for providing the very services our members want, and our communities need in order to stay healthy and grow.

Final thoughts for consideration

Credit unions are generally more conservative in their lending practices, have a more well-balanced portfolio, and overall tend to hold higher quality loans. 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, to them. We understand NCUA's goal of protecting the NCUSIF fund and limit risk, but part of NCUA's mission also includes supporting the credit union movement and industry. The proposed risk-based capital rule goes too far. The proposed rule is a solution in search of a problem, and NCUA's desire to curb industry risk will punish the credit union system and curb opportunities for healthy growth and success.

Sincerely,

Ralph Hamann

Ralph Hamann
Vice President, Finance, HR and CFO
Members Cooperative Credit Union

cc: U.S. Senator Al Franken (MN)
U.S. Senator Amy Klobuchar (MN)
U.S. Representative Richard Nolan (MN)