CoVantage
CREDIT UNION
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May 16, 2014

MAY19'14 PM 2:01 BOARD

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

RE: Comments to Proposed Corrective Action: Risk-Based Capital Rule (RIN 3133-AD77)

Dear Mr. Poliquin,

I am writing on behalf of CoVantage Credit Union, which is a community based credit union serving the residents and businesses of 20 counties in Northern Wisconsin and the Upper Peninsula of Michigan. CoVantage appreciates the opportunity to provide comments to the NCUA on its proposed rule 'Prompt Corrective Action – Risk-Based Capital'. A significant portion of our 80,000 members either operate family-owned businesses or are self-employed. Further, much of our membership are not affluent, but work hard to maintain affordable housing. It is the financial needs of members of our communities that heavily influence the types and volumes of loans funded, including significant member business loans and residential mortgages. Given the nature of our membership and our efforts to meet the membership's financial needs, CoVantage has received the status of Community Development Financial Institution (CDFI). It is from this perspective that CoVantage has grown to $1.1 billion in assets and provides a broad range of financial services.

We believe that the proposed schedules of increasing risk weighting by portfolio size for member business loans (MBLs) and residential real estate loans, and the increasing risk weighting by weighted average life on individual investments, will unnecessarily restrict the credit union's ability to build capital through earnings. The lack of recognition of risk mitigation practices such as modeling borrower and depositor behavior, asset-liability cash flow matching, and prudent use of derivatives, compounds the problem of inadequate capital development opportunities. While not an immediate threat to this credit union, the proposed rule with these characteristics could negatively affect our ability to adequately serve the varied needs of our membership in the intermediate term. Capital formation constraints that would otherwise support growth, protect deposits, and reduce the likelihood of future distributions from the NCUSIF, appear counterproductive if implemented without disclosing analysis to validate and support proposed risk weightings.

<u>Residential mortgages</u>
CoVantage funds and services a substantial residential mortgage loan portfolio, including first mortgages of about $350 million. The average first mortgage residential balance is in the $55,000 range. In addition, CoVantage services $150 million in loans sold to Fannie Mae, which are generally the longer term fixed rate mortgages. With a large number of modest-sized individual loans across our charter area that encompasses 17,482 square miles, and an average population density of about 61 people per square mile, it is hard to imagine that concentration risk would be of concern.

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Member business loans
By the nature of the members served, CoVantage funds and services a substantial member business loan portfolio. Originally formed to meet the financial needs of the patrons of an agricultural cooperative, CoVantage has provided member business loans since its inception in 1953. Total member business loans, including business real estate loans, is approaching $200 million, with an average individual loan balance of under $160,000. In addition to geographic dispersion of loans like residential real estate, member business loans are diversified across a number of retail, service, agricultural, and manufacturing industries, which reduces concentration risks embedded in the member business portfolio.

Both residential and member business loans
Both loan portfolios are supported by staffs of experienced lenders and analysts appropriate to the size of each portfolio. Credit risk is well controlled with our 60 day delinquency rate across loans of all types being at 0.72% as of March 31, 2014.

Investments
We feel the type of investment is more important than weighted average life in determining the combined risks to capital of the credit union. During the recent economic downturn, we realized mid-six figure losses in a $10 million investment which was in an approved mutual fund with a disclosed duration under 1 year. We were able to recoup this loss by selling a lesser amount of agency issued mortgage backed securities that were well seasoned, an original final maturity of 10 and 15 years, and with a weighted average life of between 3 and 5 years. This example illustrates that the issuer or type of investment being risk weighted is also an important consideration.

Interest rate risk
A basic function of community based financial institutions, including credit unions, is to manage capital and deposits to fund loans and investments in a coordinated way to preserve share balances, meet liquidity needs, and provide a fair return for depositors. A companion function is to develop sufficient earnings to adequately capitalize the financial institution. Interest rate risk embedded in loan and investment portfolios has been, and continues to be, managed through matching deposit growth and retention, investment portfolio makeup, credit union borrowings, prudent use of derivatives, modeled member behavior related to deposit decay and loan prepayment, loans and deposits repricing, and other mitigation tools. We ask that active interest rate risk management practices that mitigate this type of risk be recognized by either 'credit backs' in the risk-based capital rule, or reduce the increasing risk weighting steps assigned to classes of assets for interest rate risk.

Requests for your consideration
We urge that the proposed schedules of increasing risk weightings based on portfolio size, or weighted average life either be scaled back to risk weightings applied to other community financial institutions or be supported by disclosed objective analysis that justifies the risk weightings applied. We also request that interest rate risk mitigation practices be more explicitly recognized in this analysis.

Thank you for the opportunity to comment on this proposed rule and for considering our views on risk based capital requirements.

Douglas D. Anderson

Douglas D. Anderson
SVP CFO