CREDIT UNION ASSOCIATION OF THE DAKOTAS

May 22, 2014

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

RE: Comments on NCUA Proposed Rule: Prompt Corrective Action—Risk-Based Capital

Dear Mr. Poliquin,

The Credit Union Association of the Dakotas (CUAD) appreciates the opportunity to provide comment to the National Credit Union Administration (NCUA) with regard to the proposed amendments to Prompt Corrective Action—Risk-Based Capital. To provide a brief background, the Credit Union Association of the Dakotas represents sixty-eight state and federally chartered credit unions in the states of North Dakota and South Dakota, whose assets total over $5.5 billion and who have more than 450,000 members. Furthermore, a number of these credit unions have a long, established and proven history of providing safe and sound agricultural lending to their members.

CUAD and credit unions in North and South Dakota are extremely concerned regarding the NCUA's proposed rule to amend regulations regarding prompt corrective action, and specifically, the revisions relating to replacing the current risk-based net worth requirements with risk-based capital requirements. CUAD acknowledges that the current system is not adequate, however, the proposed rule will have devastating effects on our credit unions and their members, especially the level of risk-weights for certain categories that are being proposed by the NCUA. The proposed risk-weights will impede credit union growth and sustainability. Furthermore, credit unions will be at even a greater competitive disadvantage to other financial institutions. As proposed, this will hurt credit union members and consumers in the communities that the credit unions serve.

There are fifteen credit unions in each North Dakota and South Dakota with assets over $40 million. While the NCUA only identifies credit unions over $50 million as being immediately impacted by this rule, we believe it is better to consider credit unions $40 million in assets and over as these credit unions will also be impacted in the near future as they continue to grow. In total, these thirty credit unions hold $5,030,000,000 in assets. Under current NCUA rules, the buffer above being well-capitalized for North and South Dakota credit unions with assets over $40 million is $150,000,000. If the NCUA proposed rule were adopted without change, that buffer would drop to $40,000,000; that is a change of $110,000,000!! When looking at the buffer for being adequately capitalized for North and South Dakota credit unions with assets over $40 million, under the current rule, the buffer is $176,000,000. If the proposed rule were to be adopted that buffer would drop to $145,000,000, a difference of $31,000,000.

CUAD and our credit unions are absolutely opposed to the suggested provision in which the NCUA may establish increased individual minimum capital requirements upon its determination that the credit union's capital is or may become inadequate in view of the credit union's circumstances. There are already ample tools within the NCUA's arsenal that this proposed provision is completely unnecessary and an abuse of power.

The Federal Credit Union Act (FCUA) §216(a)(1) provides that the purpose of Prompt Corrective Action is to "resolve the problems of insured credit unions at the least possible long-term loss to the Fund." The FCUA directs the NCUA Board to prescribe a system of prompt corrective action for insured credit unions through regulation. However, the FCUA also directs that NCUA Board to take into account "that credit unions are not-for-profit cooperatives that (i) do not issue capital stock; (ii) must rely on retained earnings to build net worth; and (iii) have board of directors that consist primarily of volunteers." *FCUA §216(b)(1)(B).*

The regulations that the NCUA Board is required to implement are required to include a risk-based net worth requirement for insured credit unions that are complex. "Complex" is to be defined by the NCUA Board "based on portfolios of assets <u>*and*</u> liabilities of credit union." *[Emphasis added] FCUA §216(d)(1)*. Under the proposed rule a credit union is defined as "complex" and a risk-based capital ratio requirement is applicable if the credit union's quarter-end total assets exceed $50 million. The NCUA's proposed rule only defines a complex credit union based on assets and not liabilities as directed to by the FCUA. Under current regulations, a credit union is defined as "complex" and a risk-based net worth requirement is applicable only if the credit union meets *both* "(a) Minimum asset size. Its quarter-end total assets exceed fifty million dollars; AND (b) Minimum RBNW calculation. Its risk-based net worth requirement as calculated under §702.106 exceeds six percent (6%)." *12 CFR 702.103.*

The NCUA is improperly identifying "complex" credit unions based only on asset size and not per the directives of the Federal Credit Union Act. However, should the NCUA find legal authority that would allow credit unions to be defined as "complex" based only on asset size, the threshold needs to be significantly increased to truly identify "complex" credit unions. CUAD suggests that this threshold be increased to at least $1 billion and these credit unions work directly with NCUA in a cooperative manner to develop a risk based capital plan that is better suited for the credit union industry and will not jeopardize the future of credit unions.

The FCUA further provides that "The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be *adequately* capitalized may not provide *adequate* protection." *[Emphasis added.] FCUA §216(d)(2)*. The FCUA does not specify what risks these are, however, it is does indicate that the NCUA include ONLY those *material risks* against which the risk-based net worth requirement for an *adequately* (not well) capitalized insured credit union may not provide *adequate* protection. However, the NCUA appears to have misinterpreted this requirement under the FCUA when it states, "because the FCUA requires the risk-based measure to include all material risks, consideration was given to credit risk, concentration risk, market risk, interest rate risk, operational risk, and liquidity risk." *79 FR 1194 (February 27, 2014)*. As clearly found in the FCUA, the NCUA is not required to include ALL risks, only those that the "net worth ratio required for an insured credit union to be *adequately* capitalized may not provide *adequate* protection."

The NCUA has already adopted and implemented regulations that address a number of the risks that the NCUA deemed as "material" and required within the prompt corrective action proposed revisions. The proposed risk-weights that the NCUA claims is addressing these "material" risks are burdensome, duplicative and extremely unnecessary.

In September 30, 2012, the NCUA's rule requiring Interest Rate Risk (IRR) Policy and Program became effective. Section 741.3(b) requires that certain factors be considered in determining whether the credit union's financial condition and policies are both safe and sound. One of these factors is "the existence of a written interest rate risk policy ("IRR policy") and an effective interest rate risk management program ("effective IRR program") as part of asset liability management. Federally insured credit unions with assets of more than $50 million, as measured by the most recent Call Report filing, must adopt a written IRR policy and implement an effective IRR program." Through this proposed rule, the NCUA is contradicting itself when it wrote, "NCUA acknowledges both the range of IRR exposures at credit unions, and the diverse means that they may use to accomplish an effective program to manage this risk. NCUA therefore does not *stipulate specific quantitative standards or limits for the management of IRR applicable to all credit unions*, and does not rely solely on the results of quantitative approaches to evaluate the effectiveness of IRR programs. Assumptions, measures and methods used by a credit union in light of its size, complexity and risk exposure determine the specific appropriate standard." *[Emphasis added.] Appendix B to Part 741, Section VII.*

To address liquidity risk, the NCUA issued its final rule "Liquidity and Contingency Funding" in October 2013 which became effective March 31, 2014. In the discussion of this rule, the NCUA noted that "After careful consideration of the comments, the Board has concluded that a liquidity rule is necessary to ensure that FICUs remain resilient in times of economic stress." *78 FR 64880, October 20, 2013*. Furthermore, the discussion to the final rule notes that "in the proposed rule, the Board requested comment on whether certain Basel III liquidity measures and monitoring tools should be incorporated into NCUA's supervisory expectations for the largest FICUs. In response to comments, the Board has determined not to take up the Basel measures at this time." *78 FR 64882, October 30, 2013*. In the proposal of liquidity rule, it was explained that "the Board is exploring whether certain Basel III liquidity measures and monitoring tools should be incorporated into NCUA's supervisory expectations for the very largest credit unions, those over $500 million. Basel III's proposed standards include, for example, the potential use of such measures as a liquidity coverage ratio and a net stable funding ratio." *77 FR 44506, July 30, 2012*. First it was initially proposed that Basel III liquidity standards would only apply to credit union over $500 million, then based on comments the NCUA did not pursue the Basel measure. However, now the NCUA, disregarding previous concerns, is apply Basel standards to all credit unions over $50 million.

It is the position of CUAD that interest rate risk and liquidity risk do not remain a "material" risk when there are already regulations in place that address these issues in-depth and already require action of the credit union to manage these risks.

NCUA issued a Letter to Credit Unions, 10-CU-03, that included the enclosure, *Supervisory Letter – Concentration Risk*. This Supervisory Letter explains that "Credit union officials and management have a fiduciary responsibility to identify, measure, monitor, and control concentration risk." "It is up to credit union management to identify the risk in each product or service line, quantify the risk and set appropriate concentration limits based on the analysis." *NCUA 10-CU-03, Encl. Supervisory Letter – Concentration Risk, page 1*. Under this proposed rule, it seems that NCUA is now setting the concentration limit for credit unions, however, it is not taking into account the factors that it recommended for credit unions to evaluate. Instead, the NCUA is taking a broad stroke approach and grouping everything, such as Member Business Loans, into one bucket.

When evaluating credit union's management of risk, the NCUA examiners are directed to look at whether or not management has maintained and performed analysis of certain factors. These factors include "Origination and portfolio trends by product, loan structure, originator channel, credit score, LTV, debt-to-income ratio (DTI), lien position, documentation type, property type, appraiser, appraised value, and appraisal date; Delinquency and loss distribution trends by product and originator channel with accompanying analysis of significant underwriting characteristics, such as credit score, LTV, and DTI; Vintage tracking (i.e., static pool analysis); The performance of third-party (brokers, auto dealers, and correspondents) originated loans; and, Market trends by geographic area and property type to identify areas of rapidly appreciating or depreciating housing values." *NCUA 10-CU-03, Encl. Supervisory Letter – Concentration Risk, page 9.* These factors are ignored in the NCUA's proposed risk-based capital rule. A one-size fits all rule does not work!

The credit union's management is in the best position to evaluate and determine its acceptable risk levels. "Each product or service carries some risk of financial exposure or loss for the credit union. ***Management*** needs to perform a risk assessment which demonstrates their understanding of the risk of the product or service, quantifies the potential loss exposure, and documents a rational business decision on the acceptable concentration level based on the analysis." *[Emphasis added] NCUA 10-CU-03, Encl. Supervisory Letter – Concentration Risk, page 3.* The NCUA is essentially setting soft caps on products and services, making it economically impractical, if not impossible, for a credit union to continue to bring certain products and services to their members. NCUA appears to be managing the credit unions balance sheets instead of allowing board of directors and management, who are in the best position, to manage their own credit union.

Through the supervisory and examination process, the NCUA already has controls in place to ensure a credit union is managing its concentration risk. Again, since these controls are in place, it is the position of CUAD that for the NCUA to determine that concentration risk remains a "material" risk is in error. The tiered risk-weights of certain categories in the NCUA's proposed rule goes against its own recommendation to credit unions in evaluating risk. It does not consider any other factors within the broad category. This method is ineffective and harms credit unions. The NCUA cannot take a one-size fits all approach and ignore relevant mitigating factors.

The NCUA in the preamble to the proposed rule explains as part of the reason why it is issuing this proposed rule, "in general, credit unions have high quality capital, with retained earnings being the predominant form of capital. However, in recent years, the NCUSIF did experience several hundred millions of dollars in losses due to failures of individual credit unions holding inadequate levels of capital relative to the levels of risk associated with their assets and operations. Examiners did warn officials at these credit unions that they needed to hold higher levels of capital to offset the risks in their portfolios, but the credit union officials ignored the examiners' recommendations, which were unenforceable." *79 FR 11186 (February 27, 2014)* If all the above regulations and guidelines concerning interest rate risk, liquidity risk and concentration risk are unenforceable, why do they exist?

NCUA estimates that there are approximately 2,237 credit unions with over $50 million in total assets that would be subject to the proposed risk based capital rule. To our knowledge the NCUA has not conducted any impact study regarding this proposed rule, it has only estimated the impact. "Existing data available to NCUA, including Call Report data, ***does not contain all of the information required to analyze*** the impact of every aspect of the proposal. However, NCUA believes the current Call Report data available provides sufficient information for NCUA to reasonably estimate the impact of the proposed regulation. Accordingly, NCUA analyzed the impact of the proposed rule on credit unions using Call Report data as of June 30, 2013." *[Emphasis added] 79 FR 11187 (February 27, 2014)*. This proposed rule will have a significant impact on credit unions in rural areas and this impact has not been discussed or even acknowledged by NCUA. CUAD questions NCUA's justification for this proposed rule and requests that the NCUA conduct a proper impact study that looks at the actual impact and not just an estimate of the potential impact. NCUA needs to also justify its reasoning for being more restrictive in its rule than what is required of community banks.

Even though this proposed rule will immediately impact credit unions over $50 million, this proposal has the potential to discourage growth in credit unions under $50 million depending on their portfolio. This rule is so restrictive, what credit union would want to grow over $50 million only to be subject to its restrictions? Furthermore, this rule discourages healthy credit unions from helping struggling credit unions seeking to merge due to the impact that such a merger will immediately have on the continuing credit union's balance sheet. Any final rule adopted needs to provide a transition period for merging credit unions.

The proposed risk-weights are too restrictive and have not been justified by NCUA. For example, with regard to ALLL under §702.104(b)(1)(vi), the ALLL should not be limited to 1.25% of risk assets. As NCUA notes in its discussion of the proposed rule, "complex credit unions are bound by GAAP in maintaining the ALLL." *79 FR 11193, February 27, 2014*. If credit unions are required to maintain the ALLL, they should be afforded the opportunity to use it in calculating their risk-based capital ratio. In footnote 41, the NCUA notes that "the 1.25 percent of risk-weighted assets limitations is consistent with the Basel III framework and the regulatory capital for U.S. banks." *Id*. However, the NCUA is not being consistent with Basel III framework in many other areas, such as residential mortgages guaranteed by FHA or VA; non-delinquent loans over 25% of the credit unions total assets; other real estate loans over 10% of total assets; member business loans over 15% of total assets; or numerous areas of investments. The NCUA's attempt to justify a 1.25% cap on ALLL, claiming it is consistent with Basel III, when the NCUA has deviated significantly from other aspects of Basel III is unreasonable.

With regard to residential mortgages guaranteed by the U.S. Government through the Federal Housing Administration or the Department of Veterans Affairs under §702.104(c)(2)(ii)(D), these should not be risk-weighted at 20 percent, but instead should be risk-weighted at zero percent. The NCUA notes that "while a government guarantee against default mitigates credit risk, it does not affect interest rate risk." *79 FR 11197, February 27, 2014*. However, as noted above, there are already regulations in place to address Interest Rate Risk and furthermore, a zero percent risk rating would be in line with Basel III, should the NCUA wish to be consistent with Basel III.

CUAD is opposed to the NCUA's proposed 100 percent risk-weight for total outstanding principal amount of loans to credit union service organizations (CUSO) under §702.104(c)(2)(v)(B) and proposed 250 percent risk-weight for total value of investment in CUSOs is counter intuitive to the cooperative nature of credit unions. NCUA should not punish credit unions for investing in the credit union industry. NCUA attempts to explain their reasoning behind these risk-weights, especially for the increase of investments in a CUSO, as "this increase is due to the risk of this unsecured equity investment, which is almost always in a non-publicly traded entity. Loans to CUSOs are normally a higher payout priority in the event of liquidation of a CUSO, and thus would be assigned a risk-weight of 100 percent." *79 FR 11198, February 27, 2014*. The 250 percent risk-weight for investments into a CUSO is a disincentive for credit unions to collaborate and find ways to internally reduce costs and risks.

NCUA itself, best described CUSOs in its CUSO final rule published in the Federal Register on December 3, 2013, when it said "CUSOs provide significant value to the credit union industry by acting as a collaborative means to share risk, manage costs, and deliver services to credit union members. With their unique collaborative business model, CUSOs foster cooperation and shared innovation for credit unions to achieve economies of scale, retain expertise, and better serve their members. Thus, the NCUA Board (the Board) recognizes that CUSOs benefit both credit unions and credit union members." *78 FR 72538, December 3, 2013*. However, it is curious as to why the risk-weights in the proposed rule are so restrictive when risks were allegedly supposed to be mitigated through the December 2013 CUSO rule, "The Board is adopting this rule to improve the quality of information about CUSOs and the nature of their activities, in order to identify risks to the credit union industry and protect the NCUSIF." *Id*. Furthermore, the FCUA already places restrictions on how much a Federal Credit Union may invest in or loan to a CUSO.

Should the NCUA feel it necessary to adopt another rule to mitigate the alleged risks concerning CUSOs, it cannot treat all CUSOs the same. A CUSO that provides scholarships to area high-school graduates presents significantly less risk than a brand new CUSO engaged in new technology or a new type of lending. The NCUA previously narrowed its approach to CUSOs when it adopted a final CUSO rule that focused on CUSOs engaging in certain complex or high-risk activities. CUAD urges the NCUA to again take a risk-based approach to address CUSOs and not treat all the same.

With regard to a credit union's investment in corporate credit unions, again credit unions are being penalized for investing in the credit union industry. The proposed rule assigns a risk-weight of 100 percent to corporate credit union non-perpetual capital and 200 percent to corporate credit union perpetual capital; however, no justification for this high risk-weight appears to be given. NCUA issued a final rule in 2010 that significantly revised the regulations that govern corporate credit unions. In the discussion of that 2010 final rule, NCUA stated, "Ultimately, the primary purposes of this extensive rulemaking were twofold. First, NCUA wanted to design a corporate rule that would prevent the catastrophic losses that occurred in the corporate system beginning in 2007 from ever recurring. Second, NCUA wanted to allow for the survival of some form of a well-run corporate system that could provide necessary services, including payments systems services, to its members, and build and attract sufficient capital. The Board believes this final rule accomplishes these two purposes." 75 FR 64787, October 20, 2010. Again, the NCUA is contradicting itself. In 2010 the goal was to build and attract capital in corporate credit unions, but now credit unions will be penalized for doing so.

As proposed, member business loans (MBL) would be risk-weighted at 100 percent for MBLs less than or equal to 15 percent of assets; 150 percent for any MBLs greater than 15 percent of assets and less than or equal to 25 percent of assets; and 200 percent for the total amount of MBLs greater than 25 percent of assets, other than MBLs included in Category 3 (50 percent risk-weight). The NCUA reports that "only 70 of the credit unions holding MBLs have MBL portfolios in excess of 15 percent of total assets." *79 FR 11197, February 27, 2014*. CUAD represents a number of these credit unions holding MBLs in excess of the 15 percent of total assets. These are credit unions that serve predominately rural areas by offering agricultural loans. These are also credit unions that are offering loans to help develop areas that are facing housing shortages. These credit unions have either obtained an exemption from the NCUA or have been grandfathered in.

This proposed rule will inhibit the future of member business lending in North Dakota and South Dakota. The proposed rule improperly treats all MBLs the same, grouping agricultural loans with more risky speculative-construction loans. There are many credit unions in the Dakotas that have an extremely long history in member business lending, with the expertise, operational processes and managerial oversight in place, and has been in place, to be very successful in making low-risk loans to their members. The proposed rule does nothing to take into account how MBL risk is mitigated through the experience that these credit unions have. Furthermore, if the rule were to be finalized as proposed, many of these credit unions would have to cease member business lending to come into compliance, including ceasing agricultural lending, thus removing another lender from the marketplace. In some rural locations in the Dakotas, the credit union is the only agricultural lender. This proposed rule will hurt the consumer and the American farmer.

CUAD believes the proposed 250 percent risk-weight for mortgage servicing assets (MSA) is too high and unsupported by NCUA. The proposed rule would define "mortgage servicing asset" as "those assets (net of any valuation allowances) resulting from contracts to service loans secured by real estate (that have been securitized or owned by others) for which the benefits of servicing are expected to more than adequately compensate the servicer for performing the servicing." *79 FR 11211*, *February 27, 2014*. In the proposed rule's discussion, the NCUA explains that "the proposal would address the complexity and variability of the risks, including interest rate risk and market risk, associated with a MSA by assigning a 250% risk-weight. MSAs can become impaired when interest rates fall and borrowers refinance or prepay their mortgage loans. This impairment can lead to earnings volatility and erosion of capital. Additional risks include those associated with valuation and modeling processes." *79 FR 11198, February 27, 2014.* While there is risk in MSAs if the member refinances or prepays their mortgage loan, that same risk would be present for loans held in house. However, first mortgage loans are only assigned a risk-weight of 50% to 100% depending on concentration level, with other real estate loans having a risk-weight of 100% to 150%. There are many other risks present when the mortgage loan is held in house in addition to the minimum risk of the member refinancing or prepaying the mortgage loan. A 250% risk weight for mere servicing of a mortgage loan is ridiculous and completely unsupported by the actual risk.

CUAD is opposed to the proposed risk-weights for investments. We recommend that the NCUA adopt the risk-weights for investments consistent with the risk-weights in use by other financial institutions. The proposed rule, while keeping in line with the current rule, would risk-weight all investments based on the "weighted-average life of investments" (WAL). However, we believe it is more appropriate that risk-weights for certain investment should be significantly lower based on their guarantee. Securities guaranteed by the U.S. Government sponsored agencies, securities guaranteed by general obligations of state and local government and securities guaranteed by revenue obligations of state and local governments present a much lower risk and therefore the proposed risk-weights should be lowered to more accurately reflect the actual risk. We recommend that these investments be weighted the same as under Basel III.

NCUA has proposed a risk weight of 200 percent for investments with a WAL of greater than ten years. We believe this risk weight is still too high. If a credit union and bank enter into the same exact investment, it makes absolutely no sense why a credit union should be penalized so harshly whereas a bank's risk weight for the same investment is half of what a credit union's would be.

Under NCUA's current rules and regulations, a credit union is permitted to pay dividends without regulatory approval only from undivided earnings. The proposed rule under §702.114(a) would provide, "dividends shall be available only from net worth, if any." Furthermore, current rules regarding the payment of dividends, provisions relating to payment of dividends if undivided earning are depleted would be revised to address the payment of dividends if retained earnings are depleted. Similar to current rules, the board of directors can authorized the payment of dividends only if their net worth classification does not fall below adequately capitalized. If the payment of dividends does cause the net worth classification to fall below adequately capitalized, the credit union would still need to seek prior written approval from either the appropriate Regional Director and, if State-chartered, the appropriate state official to pay the dividend. However, the proposed rule would also add the requirement that the "request for written approval must include the plan for eliminating any negative retained earnings balance." *79 FR 11221, February 27, 2014.*

“Secondary capital accounts would continue to be excluded as a direct source of dividend payments. Dividends would not be considered operating losses and could not be paid out of secondary capital.” *Id. at 11205*.

Furthermore, the proposed rule would add restrictions on payment of dividends if the credit union’s net worth would be less than 6 percent after said payment. The NCUA’s reasoning for this provision is that it, “would prohibit a credit union from unreasonably dissipating its capital through excessive dividend payments or a refund of interest in a manner that would undermine the safety and soundness of the credit union. In particular, the proposed rule would prohibit a credit union currently classified as well capitalized from paying dividend rates that are higher than the prevailing market rates, declaring a non-repetitive dividend, or approving a refund of interest if, after the payment of the dividend, the credit union’s net worth ratio would decline to less than 6 percent in the current quarter. This new provision would prevent the unsafe dissipation of capital through the payment of special or bonus dividends or interest refunds while still allowing for continuity of operations.” Id. at 11206. CUAD is opposed to any additional restriction on the payment of dividends as credit unions may suffer a reputational risk if members become alarmed that their credit union is not sufficiently capitalized to be able to pay dividends.

The NCUA is proposing a mere 18 months to implement the final rule. This time frame is too short and credit unions will be struggling to meet the requirements of the final rule within 18 months. It will be a virtual impossibility to rearrange a balance sheet in a safe and sound manner in only 18 months. Banks were provided with multiple years to implement Basel III. NCUA has not justified a reason why credit unions should implement this rule in such a short time frame. Should a final rule be adopted, credit unions will require at least five years to restructure their balance sheet.

Finally, CUAD is opposed to the provisions in the proposed rule that would allow the NCUA to require a credit union to retain more capital above what would already be required under the rule, even if well-capitalized, on a subjective basis. The current rule already provides that the NCUA Board may reclassify a credit union under 12 CFR 702.102(b). This authority is retained in the proposed rule with minor changes and provides that “the NCUA Board may reclassify a well-capitalized credit union as adequately capitalized and may require an adequately capitalized or undercapitalized credit union to comply with certain mandatory or discretionary supervisory actions as if it were classified in the next lower capital category (each of such actions hereinafter referred to generally as ‘‘reclassification’’) in the following circumstances: (1) *Unsafe or unsound condition.* The NCUA Board has determined, after notice and opportunity for hearing pursuant to § 747.2003 of this chapter, that the credit union is in an unsafe or unsound condition; or (2) *Unsafe or unsound practice.* The NCUA Board has determined, after notice and opportunity for hearing pursuant to § 747.2003 of this chapter, that the credit union has not corrected a material unsafe or unsound practice of which it was, or should have been, aware.” *79 FR 11213 (February 27, 2014)*.

Furthermore, the regulations require the NCUA Board to consult and seek to work cooperatively with the appropriate state official before reclassification of a state-chartered credit union. CUAD believes this is a more than adequate tool for the NCUA Board to use in the event of unsafe or unsound conditions or practices.

However, in addition to this reclassification that the NCUA may already do, the proposed rule would add new powers under §702.105 that would provide that the "NCUA may establish increased individual minimum capital requirements upon its determination that the credit union's capital is or may become inadequate in view of the credit union's circumstances." *79 FR 11216 (February 27, 2014)*. This proposed power does not limit itself to the NCUA Board and does not require any cooperation with state officials. Furthermore, these "minimum capital requirements" may be higher than the already restrictive risk-based capital requirements under the proposed rule. The proposed rule provides a number of examples of when higher capital levels may be appropriate, such as when the NCUA determines that "a credit union has a high degree of exposure to interest rate risk, prepayment risk, credit risk, concentration risk, certain risks arising from nontraditional activities or similar risks, or a high proportion of off-balance sheet risk; a credit union is growing, either internally or through acquisitions, at such a rate that supervisory problems are presented that are not adequately addressed by other NCUA regulations or other guidance; a credit union may be adversely affected by the activities or condition of its CUSOs or other persons or entities with which it has significant business relationships, including concentrations of credit; or a credit union has inadequate underwriting policies, standards, or procedures for its loans and investments." *Id*.

CUAD is opposed to any provision that provides NCUA with a subjective power to increase individual minimum capital requirements upon its determination that the credit union's capital is or may become inadequate in view of the credit union's circumstances. Such power is unnecessary and has the potential to be abused, especially as it is not limited to being exercised only by the NCUA Board and does not require cooperation with state officials. Provisions under proposed section 702.102(b) for reclassification based on supervisory criteria other than net worth are more than adequate to address NCUA's concerns.

CUAD acknowledges that the current risk-based net worth system is not adequate; however, the proposed rule will have devastating effects on North and South Dakota credit unions and their members. If the proposed rule were finalized, meeting its requirements would destroy profitability and reduce benefits to members. The sustainability of credit unions would also be called into question. A new system needs to be less restrictive than the proposed risk-weights and also take into account that not all products in one particular category are created equal. Furthermore, the new system should not be duplicative and address risks that are already being managed by credit unions and examined by NCUA through other rules, regulations and guidance issued and enforced

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by the NCUA. In addition, CUAD urges NCUA to reach out and work collectively with the industry to create a fair and balanced rule that protects the share insurance fund while allowing safe, secure, financially sound credit unions to grow and serve the changing needs of their members. CUAD implores the NCUA to please make a greater effort in the future to reach out to industry to fully understand the impact its proposed rules could have on various credit unions and the industry as a whole prior to issuing proposed rules. In particular, those proposed rules such as this one that will have severe implications to credit unions. Doing so would be good both for the regulator and the industry.

Thank you for this opportunity to share our comments and concerns.

Respectfully,

Robbie Thompson
CEO/President

Amy Kleinschmit
VP of Compliance