Hometown
CREDIT UNION

Kulm Office | PO Box 310 | Kulm, ND 58456
701.647.2448 | Fax 701.647.2449 | 877.304.0035

Ashley Office | PO Box 230 | Ashley, ND 58413
701.288.3439 | Fax 701.288.3430 | 877.588.3439

Hazelton Office | PO Box 225 | Hazelton, ND 58544
701.782.6841 | Fax 701.782.6831 | 866.782.6841

May 28, 2014

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

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

Dear Mr. Poliquin:

This letter is being written on the behalf of the Hometown Credit Union, located in Kulm, ND. At the request of our Board of Directors and our Management Team, I am taking this opportunity to comment on the proposed modernization of the risk-based capital rule for credit unions. This rule was announced by the NCUA Board back in January, and the comment period is set to run through May 28th.

Before I begin my discussion regarding the proposed regulation, I would like to tell you a little about our Credit Union. The Hometown Credit Union was chartered in 1949 as the Kulm Credit Union. We are a state chartered credit union with a community based field of membership. The sole reason for our existence was to provide financial services to members of the local community. Kulm is a small town of about 400 people, whose economic base is and always has been agricultural in nature. Thus our members are primarily farmers and ranchers that live and work within a 75 mile radius of Kulm. In 1987 we established a second branch office in Ashley and in 1995 we established a third branch office in Hazelton. Ashley is a community of about 800 people and Hazelton has a population of roughly 200. On June 6, 1988 our name was changed to the Hometown Credit Union, to reflect that while our membership base was expanding, our commitment to our home towns remained strong.

The Hometown Credit Union is a small but growing organization. We had about $15 million in Assets in 2000 and today we have nearly $87 million in Assets and our Assets are predominantly made up of Ag loans. As you can see our growth has been significant over the past 15 years, but most of this growth is not due to taking on more and more borrowers, the largest portion of our growth is due to the huge changes that have taken place within the agricultural economy. Land which used to sell for $300/ac is now selling for over $2,000/ac. Fertilizer which used to cost $150/ton is now selling for $600/ton. Breeding cows which used to sell for about $800/head are now bringing over $2,000/head. A farmer that used to be able to plant an acre of wheat for only $100, now needs a $500 investment to grow an acre of corn. Nearly every single input our members need or use within their operations, have tripled or quadrupled in just the last 15 years, and our loan balances have grown accordingly. Fortunately we have been profitable and have been able to maintain our capital levels at a safe level.

Our growth has brought many growing pains, but we have utilized technology to meet the challenges and we have increased our staffing to handle the growing documentation needs. Our Credit Union has a Low-Income Designation, as the majority of our membership qualifies as Low-Income Members. Many of our MBL's are made to small businesses, farms, and ranches which are considered low-income but make up a huge proportion of our business. These loans are made to honest, hard-working, Americans. People that may not have a lot of financial resources, but have a work ethic and an impeccable integrity that you cannot find in other parts of this country. Our Hometown Credit Union has proven that these MBL's can be profitably administered and are not overly risky, even though our over-all Agricultural Loan portfolio makes up nearly 80% of our total loans and comprises about 64% of our total assets. We have an experienced lending staff, a staff that knows how to service MBL's, and we have never had a large problem with defaults or even delinquencies, because we understand farming and ranching. We understand agriculture and its inherent risk, we live it every single day, and we know how to structure and secure our loan portfolios to minimize the risk to our Credit Union, to our Members, and to the NCUA.

Out here in rural North Dakota, we believe in hard-work, honesty, and the golden rule. We treat others like we would like to be treated and we feel that everyone should play by the same rules and be treated fairly. Which brings me to the part about this newly proposed RBC regulation that really sticks in my craw and that is the fact that the capital requirements that would be imposed on Credit Unions will be significantly more burdensome than the capital regulations being imposed on Community Banks. I would like to ask NCUA, how can you justify this? Why were the Basel III risk weightings that Banks must adhere to not followed, or worse yet not even considered, when this extremely flawed proposal was being developed?

As proposed, the new regulation will require that all MBL's in excess of 25 percent of assets be risk rated at 200% and all MBL's above 15 percent but less than 25 percent of assets will be risk rated at 150%. What is the possible rationale for this burdensome regulation? Why is it designed to hit rural credit unions much harder than anyone else? Our members are predominantly farmers and ranchers, they need loans to finance crop production, purchase livestock, buy equipment, and secure the real estate upon which all production is based. Agricultural loans are considered Member Business Loans and thus our loan portfolio would be severely punished under the proposed RBC guidelines. We would have to either curtail our Ag lending significantly or come up with about $3,000,000 of additional capital, just to maintain our Well-Capitalized status. We currently have Capital of nearly 11% of Total Assets, is it really necessary to raise this to over 14%?

But here is what makes this proposal especially concerning. If we assume that our small ND credit union grows its loan portfolio by $20 million over the next 5 years, and if we assume that nearly all this growth is in MBL's, we will need another $4 million of capital to fund this growth. Plus we need $3 million of capital to maintain our current well-capitalized status, this gives us a total capital need of $7 million. This would basically take every single dollar of our expected profits, just to build capital.

We would not have the ability to branch into another small rural community that may be underserved. We would not be able to upgrade our facilities to better serve our loyal members. Nor would we be able to add needed staff positions such as an IT officer, a Compliance officer, a Residential real estate lender, or a Human Resources manager. We would have to use our net income to build capital, leaving nothing to improve our customer service or add new technology.

Meanwhile, down the street, our community bank, which is making the exact same types of loans, will only need about $2 million of capital to fund the same level of growth, a savings of $5 million dollars. What a huge competitive advantage for them and what a huge disservice to every member of the Hometown Credit Union. How can this total disregard for fairness be tolerated? It is inconceivable that this regulation be approved in its current state.

Here are a few more items that further demonstrate the folly of the proposed RBC changes:

1) The Hometown Credit Union has been in existence for 65 years and our total Net Charge-Offs over that time-frame is $1,462,000 or an average of $22,000 per year. We will have to add $3,000,000 of capital, just to stay well-capitalized, which at historic loss rates should more than cover our losses for the next 100 years.
2) I read that an agricultural credit union has never caused a loss to NCUA because of lending issues. There have been losses due to embezzlement, poor management, etc, but not because of risky lending. Why are the small ag credit unions going to be the ones most affected by this regulation? That is like fining the butcher because the baker broke the rules, it quite simply does not make sense. I would guess that the majority of the banks and credit unions that failed during the last recession were primarily involved in risky, speculative, construction and development lending. Maybe that is where the higher capital standards need to be applied?
3) I also read that 92% of all credit unions would not be affected by the proposed rule and would still be considered well-capitalized under the proposed formula. That is likely true, the vast majority of credit unions in the United States do not have a large MBL portfolio, but does that make them safer? I would venture to guess that most of these small credit unions are only marginally profitable and likely survive by making low margin automobile and residential real estate loans. I would argue that since they are marginally profitable, they are also weaker, as they cannot overcome losses caused by an economic downturn, because they simply do not have the profits to replace the lost capital. By the way wasn't it residential real estate loans that caused the bulk of the problems during the financial crisis? Hmm, it appears that we are punishing the wrong people.
4) An ironic fact about the proposed regulation is that I could take and sell off $20 million of our best performing farm loans (200% risk weighted) and replace them with $20 million of **delinquent** first mortgage residential RE loans (100% risk weighted) and in effect reduce our capital needs by $2,000,000. Did this really make our portfolio safer? I may not have a PHD in economics, but I have serious concerns regarding a regulation that would seemingly condone this.

Another significant concern that I have with the new RBC proposal is that it assumes that as the % of MBL's or even First Lien RE loans in a portfolio increase, somehow that additional dollar of loans is riskier than the first dollar of loans booked. I think it may be just the opposite. The more volume of any type of loan you have in your portfolio, the more expertise your lending staff has, the more support staff you have to service those loans, the better you understand the collateral securing those loans, the lower your over-all risk. If you only have 1% of your portfolio into 1-4 family residential loans, you probably are not an expert at putting those loans on the books. You will likely have a higher loss ratio on those loan types than if you did 40% of your volume in those types of loans. This is not what the new proposal promotes. I think if a certain loan type is inherently more risky (ie construction and development loans) then every loan of that type in the portfolio should be risk rated at a higher level. There should not be a higher risk weighting just because 15% or 25% or 35% of your portfolio is of a certain type. In my opinion, a higher percentage just means you are meeting your market niche and that you probably have the expertise to handle those loans better than an institution that rarely deals in that loan type.

Another concern is the significantly higher risk weight that the new RBC proposal applies to investments with longer WAL's. First of all, why is it that if a bank and a credit union enter into the exact same investment, why is the credit union penalized with a much harsher capital requirement? Second of all, I would argue that a portfolio of investments that is well balanced among different maturities is actually the safest. Have you heard of the term laddering your portfolio? Laddering allows you to obtain higher returns with little if any additional interest rate risk. In a rising rate environment it is true that an investment with a longer maturity is riskier, but in a falling rate environment it is that longer maturity bond that will give off significant earnings to offset losses in other areas. I know this to be true as the bank I was formerly with cashed in and took gains out of their bond portfolio to offset losses being suffered on the loan portfolio. It actually made the overall losses more tolerable. We should not risk weight investments based on WAL, but only base on type. I also believe that any bond with implied government backing should not be risk weighted at more than 20% and if it has 100% government backing those loan types should be risk weighted at 0%.

Another concern is that the NCUA is proposing only an 18 month implementation period for the new RBC regulations. Why? Banks were given multiple years to comply with Basel III, it would be only fair to allow credit unions at least a comparable time frame, as restructuring a balance sheet does not happen overnight. At the very least we should be given 5 years to complete our compliance, with the much more restrictive capital requirements this regulation presents.

Lastly, this proposed regulation, though well intentioned, is just patently unfair. It should have copied Basel III nearly identically. NCUA did not need to re-invent the wheel, it just needed to follow the lead of the FDIC. If our banking system is safe under Basel III, then I think our much smaller credit union system will also be well served by utilizing the same regulation as banks. The proposed risk-weights that the NCUA is claiming will make the system safer, will only increase the competitive disadvantage that small credit unions have against the large banking system.

The new regulations are burdensome, duplicative, and extremely unnecessary and only serve to punish the stronger, more profitable credit unions that are successfully competing with the banking industry. NCUA must justify its reasoning for being more restrictive in its rule than what is required of community banks!

We work very hard to support our communities and meet the financial needs of our members. We also take the responsibility, of protecting our member share savings & share draft accounts, very seriously. We utilize the NCUA to insure that all our member funds are kept safe and secure, so that no matter what, our members never have to worry about losing their hard earned deposits. But increasing our capital requirements to unprecedented levels is not making the system safer, it is just putting unnecessary road blocks out that will ultimately make it more expensive for us to provide services to our members. They will have to pay more for their loans and higher fees on their accounts, but I do not think that it will make the system significantly safer. It will allow regulators to ignore poor practices because at least at the surface it will appear that the financial institution is well capitalized. But is it well run, is it profitable, is it actually safer?

I urge NCUA to learn from this episode and make a greater effort to reach out to the industry before unilaterally instituting a regulation that is this highly controversial. The NCUA needs to work with its credit union members and not against them. The NCUA needs to realize that we, the credit unions of this great county, want to create a fair and balanced rule that protects our industry but yet allows us to grow and serve the needs of our members. The NCUA needs to understand that ultimately we pay for the operation of your agency, that we pay for the losses suffered by the credit unions that previously failed, and that we above all else, want to protect the share insurance fund. We just do not want the regulations forced upon us. We want to be consulted prior to rules being proposed. We want to be a partner in preserving our industry for the benefit of all.

Thank you for this chance to share my comments and concerns.

Sincerely,

Harold M. Hagen

Harold M. Hagen
CEO/President
Hometown Credit Union